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Politics this week

Jul 30th 2009
From The Economist print edition

The **Democratic Party of Japan**, which is favourite to win an election on August 30th, produced its manifesto. It calls for a child allowance, higher unemployment benefits, lower road-tolls—and a radical shake-up of the system that gives civil servants huge influence over politicians. See article

Kyrgyzstan's president, Kurmanbek Bakiev, easily won re-election. Opposition protests were broken up by the police. The Organisation for Security and Co-operation in Europe judged the conduct of the poll a disappointment. See article

The vice-president of China's supreme court said the country would reduce **death-penalty** executions "to an extremely small number". In 2008 China executed more than 1,700 people, or 72% of the world's total.

At talks in Washington, DC, **America** and **China** promised to resist protectionism and to work together to slow climate change. But they failed to produce any detailed new agreements.

Marching for Manuel

AFP

Manuel Zelaya, the deposed president of **Honduras**, set up camp together with several hundred supporters just over the border in Nicaragua, to pressure the de facto government to accept a mediation plan that would restore him to power. The army said it would accept the plan; Roberto Micheletti, the de facto president, asked for more talks. The United States withdrew diplomatic visas from four members of his government. See article

Sweden's government asked **Venezuela** to explain how anti-tank rocket launchers sold to the Venezuelan army had come into the hands of Colombia's FARC guerrillas. The Colombian army found the weapons in a FARC camp. Venezuela's president, Hugo Chávez, said there was no evidence to link the weapons to Venezuela, and recalled his ambassador from Colombia—not for the first time.

At least 15 people were drowned and some 70 more were missing after an overloaded sailing boat carrying **Haitian migrants** capsized off the Turks and Caicos Islands in the Caribbean. More than 100 people were rescued.

Active on all fronts

A flurry of visits by senior members of the Obama administration to **Israel** and the surrounding region, including George Mitchell, a special envoy, Robert Gates, the defence secretary, and Jim Jones, the national security adviser, highlighted Barack Obama's apparent determination to get a Middle East peace process going again. See article

Iran's beleaguered president, Mahmoud Ahmadinejad, came under fire from his hitherto stalwart conservative allies in the ruling establishment, when they prevented him from making his son's father-in-law the country's vice-president. But he made him his chief of staff instead, and fired the head of intelligence for criticising the initial appointment. See article

At least seven **Iranian** members of the People's Mujahideen of Iran, a dissident group that took refuge in Iraq under the auspices of Saddam Hussein, who gave them their own camp north of Baghdad, were killed in a raid by Iraqi security forces. The Iraqi government wants to close Camp Ashraf, whose occupants are afraid they may be sent back to Iran.

In a presidential and general election in **Iraq's** autonomous Kurdish region, a new party called Change shook the ruling duopoly of the Kurdish Democratic Party, run by the Barzani clan, and the Patriotic Union of Kurdistan, run by the Talabanis. The new party won about a third of the seats. See article

Islamist militants attacked government police and troops in several northern **Nigerian** states after some of their suspected leaders were arrested. Hundreds of people were killed and injured in the subsequent violence over the course of at least five days. See article

AFP


Deadly intent

ETA, a Basque separatist group, was blamed for two car-bomb attacks on police barracks in Spain. The first device, in Burgos, injured 65 people. The second blast, on the tourist island of Majorca, killed at least two people.

More worries were voiced about the struggling Baltic economies as data showed **Lithuania's** GDP had shrunk by 22% year on year in the second quarter. After frantic negotiations, the parties in **Latvia's** ruling coalition agreed to a package of austerity measures to secure IMF aid.

The European Union asked for a formal assessment of **Iceland's** application to join the 27-nation block, putting the Nordic country on a fast-track to membership, possibly within three years' time. Iceland reversed its cool attitude towards the EU last year, when its banking system collapsed.

A smattering of Labour MPs blamed **Gordon Brown** for the party's defeat in a by-election for a seat in Norwich, which was won handily by the Conservatives. But no one openly ventured to push for a leadership challenge to the prime minister.

Toil and trouble

Amid increasing rancour among the various committees in Congress that have responsibility for **health-care reform**, Barack Obama went out to stump for his plan. But many Democrats said the president needed to offer clearer leadership. See article

Lawmakers in **California** approved the budget deal thrashed out between Arnold Schwarzenegger, the governor, and legislative leaders. The package plugs the state's budget deficit gap, though last-minute negotiations removed some items that had been earlier agreed on, such as the first lease for 40 years to allow oil drilling off Santa Barbara.

The Senate Judiciary Committee endorsed **Sonia Sotomayor's** appointment to the Supreme Court; she picked up the support of one Republican senator. A few other Republicans have said they will vote for her when the full Senate deliberates.

Mr Obama's comments on the **arrest** of Henry Louis Gates, a professor of black studies at Harvard University, sparked a row. Mr Obama had said that although he didn't know the facts about the arrest of Mr Gates for disorderly conduct at his home, the police had "acted stupidly". After the Cambridge police association stoutly defended the arresting officer (left), Mr Obama admitted his comments had made the controversy worse, and invited both Mr Gates and the sergeant to the White House for a beer.

Business this week

Jul 30th 2009
From The Economist print edition

After months of speculation and a failed merger effort, **Microsoft** and **Yahoo!** announced an agreement to integrate their internet-search and advertising businesses. Under the deal, Microsoft will incorporate Yahoo!'s search technologies into its existing web-search platforms while its Bing search engine will operate on Yahoo!'s websites. Microsoft will enter a revenue-sharing partnership with Yahoo!. Between them, the two account for 28% of internet searches in America, compared with Google's 65%. See article

There was more evidence that **housing markets** may be turning a corner. Sales of new homes in America jumped by 11% in June compared with May, the biggest increase in nearly nine years. And the S&P/Case-Shiller home-price index for May rose by 0.5%, its first gain since mid-2006. The Land Registry's survey of house prices in England and Wales recorded its first advance, 0.1%, in 17 months. See article

The head of the Obama administration's task-force on the car industry assured a congressional panel that the reconstructed management boards at **Chrysler** and **General Motors** were in complete commercial control of their companies and that "there is no checking with the government". Ron Bloom also warned lawmakers not to pass a measure reversing the cuts in car dealerships made by the companies because it would shake market confidence.

The freight depression

TUI, a German tourism group, agreed to provide the bulk of short-term financing requested by **Hapag-Lloyd**, which the container-shipping line needs to stay afloat. TUI has sold 57% of its stake in Hapag with a view to leaving the **shipping industry**. Meanwhile, Japan's three biggest shipping companies all reported quarterly losses, which they blamed on the global slowdown. See article

It emerged that a provisional report prepared for France's financial-market regulator into alleged insider share dealing at **EADS** had recommended fines for former and current executives at the aerospace company. Two of its biggest shareholders, Lagardère, a French media group, and Germany's Daimler, were cleared of wrongdoing.

Two giant public offerings in **China**, including that of China State Construction Engineering, whose IPO was the world's biggest so far this year, helped to propel the country's stockmarkets upwards. The exuberance was halted by rumours that China's biggest banks may curb lending.

Singapore's state investment company, **Temasek**, said the value of its assets had fallen by a fifth, or S$40 billion ($28 billion), for the year to March 31st, and raised the possibility of allowing the public to "co-invest" in its operations. A recent report from Deutsche Bank drastically cut forecasts for growth at sovereign-wealth funds worldwide.

Rearranging the chairs

Lloyds Banking Group appointed Sir Win Bischoff as its new chairman. He replaces Sir Victor Blank, a leading proponent of Lloyds TSB's acquisition of HBOS last year, which many shareholders consider a mistake. Sir Win stepped down as chairman of Citigroup in February.

Deutsche Bank reported a sizeable increase in net profit for the second quarter, to €1.1 billion ($1.5 billion). However, investors took fright at the German bank's provisions for bad loans, which swelled to €1 billion. Meanwhile, Deutsche said that its management and supervisory boards had not authorised the investigation of managers and a major shareholder in Germany's latest corporate-spying allegations.

State prosecutors are reviewing the evidence.

The average daily volume in Britain's **foreign-exchange market**, the world's largest, fell to $1.36 trillion in April, a fifth lower than last October, as transactions slowed between banks and other financial companies. America's foreign-exchange market shrank by 31% in the same period.

Verizon, America's second-biggest telecoms company, announced a further 8,000 job cuts at its landline division.

The quarterly earnings season got under way for big **oil companies**, in which most are expected to report much reduced profits because of falling oil prices and weaker demand. Royal Dutch Shell's net profit dropped by 67%, to $3.8 billion. ConocoPhillips's profit fell by 76%, and BP's by 53%.

To boldly go

Abu Dhabi's Aabar Investments said it would pay $280m for a 32% stake in **Virgin Galactic**, Sir Richard Branson's space-tourism venture. Aabar plans to build facilities for a regional "spaceport" in the emirate, which it hopes will attract scientific research. Virgin Galactic is offering flights to space for $200,000 from a spaceport in California's Mojave desert, starting in 2011.

KAL's cartoon

Jul 30th 2009
From The Economist print edition

Illustration by KAL

A difficult summer for the White House

Crunch time

Jul 30th 2009
From The Economist print edition

The next few weeks could determine the fate of Barack Obama's presidency

IF THE opinion polls are to be believed, Barack Obama is now, six months into his presidency, no more popular than George Bush or Richard Nixon were at the same stage in theirs. His ratings are sagging particularly badly with electorally vital independent voters: two-thirds of them think he wants to spend too much of their money. Two of the most specific pledges he made to the electorate—to reform health care and to produce a cap-and-trade system to curb greenhouse-gas emissions—are in trouble. And an impression is being formed in Washington of a presidency that is far too ready to hand over the direction of domestic policy to Congress; that is drifting either deliberately or lethargically leftwards; and that is more comfortable with lofty visions than details. On the campaign trail Mr Obama showed an impressive ability to change gears. He needs to do so again this summer.

His cause is by no means hopeless. Just as his initial Messianic polling numbers were misleadingly optimistic, his problems should now be put into context. Most obviously, nearly 200 days into office, he has avoided making any horrific mistakes, especially in the fraught business of economic policy. On the hardly insignificant matter of restoring America's reputation in the world he has delivered a degree of what he promised (though even there the tough times are still ahead of him, as our next leader makes clear). He has had to cope with the worst recession for half a century. He has been curiously ill-served by a press short of useful criticism, with liberal America prepared only to debate what sort of water he walks on best, while conservative radio hosts argue over when exactly he became a communist. And of course, government is darned hard: even when you make the right decision—to close Guantánamo, for instance—it can take years to put into effect.

So Mr Obama's underperformance is relative and partial; but it is serious, especially in domestic policy. And if his schemes at home come to naught, then his credibility abroad will wither. That is why the next few weeks are crucial.

Taking too much care of Hillarycare

In foreign policy an American president enjoys the most freedom of operation. At home the man in the Oval Office is mightily constrained by Congress. It is the artful combination of arm-twisting, compromise, rhetoric and gritty attention to detail that make the difference between an FDR and a Jimmy Carter. Back in his honeymoon days Mr Obama was constantly compared to Roosevelt. No longer.

The suspicion is that the president has taken the experience of Bill Clinton too much to heart. The previous Democratic presidency got off to a rocky start for many reasons, but his failed attempt to

impose health-care reform on Congress in 1993-94 bulks largest. Putting Hillary Clinton in charge of an unwieldy, secretive task-force that attempted to present powerful senators with a masterplan backfired. Congress promptly shot it down—and Mr Clinton lost both the House and the Senate to the Republicans in 1994.

A president plainly should not ignore Congress. But Mr Obama has veered to the opposite extreme. Although he has a White House stuffed full of first-rate policy wonks, he has repeatedly subcontracted the big decisions—the $787 billion stimulus bill, cap-and-trade, health reform—to the Democratic leadership in Congress. At times Mr Obama's role has seemed limited to deploying his teleprompter-driven oratory to sell whatever Congress proposes to the public, even before it is clear what exactly those proposals amount to.

Nobody voted for President Pelosi

Worse, the plans have usually ended up running away from tough decisions. With the stimulus bill the flaws were forgivable: there was an urgent need to give the economy a boost. But the House of Representatives has produced a cap-and-trade bill that is protectionist, riddled with exemptions and which gives away the permits that are supposed to force carbon-emitters to change their ways. There is a growing danger that this bill will not be passed through the Senate and reconciled with the House version in time for the Copenhagen summit on climate change in December.

With health care, Mr Obama's preference for vague statements of principle rather than detailed specification has led to a House proposal that loads taxes onto the rich, sets up a state-run insurance scheme that many fear will put private-sector providers out of business and fails to contain, let alone reverse, the escalating costs of treatment while adding an expensive requirement that everyone have health insurance, with large subsidies where needed (see article). Barely any Republicans could support this proposal as it stands. Frantic efforts to save the reform effort are under way in the Senate, but it is distinctly odd to note that the president's signature policy is now being devised for him by a gang of six senators. Financial regulation is also stuck (see article).

A policy of ramming bills through Congress on a party-line basis might suit Nancy Pelosi, the Democrats' leftish leader in the House. But, from Mr Obama's point of view, it is bad politics in two different ways. It is shifting the presidency to the left, annoying centrist voters who worry about the swelling government debt. And it may not even get the bills through. Conservative Democrats, many of whom represent right-leaning states and districts recently captured from the Republicans (see article), are nervous about backing bills without bipartisan support. Over 40 of them broke ranks in the House over the climate-change bill. Now there is the likelihood that health reform, like the climate-change bill, will be deferred until the autumn, when fears about the deficit will have grown and the two expensive bills could combine to spook voters.

What should Mr Obama do? He must come down from his cloud and start leading. The House Democrats could be usefully reminded that their present 78-seat margin owes everything to the president's coat-tails; they are endangering his popularity. Mr Obama should also court centrist Republicans. That means getting into the nitty-gritty: Republicans can hardly be expected to save Mr Obama's presidency unless they get something solid in return. For instance, one way to pay for bringing the uninsured into the health-care system (a noble Democratic priority) is to scrap a distorting tax-deduction that veils the true cost of health insurance, a policy espoused by John McCain last year. A real "post-partisan" president would be trying to bully through this compromise, not talking dreamily about wanting health care for all at no cost to anybody but the rich. And on the subject of detail, precise talk from the president about how he intends to grapple with government debt would reassure a lot of centrist waverers.

None of this is impossible. As *The Economist* went to press, hopes were rising that the Senate finance committee might soon produce a bipartisan version of the health bill. But then the final version of that bill will have to be reconciled with the much-worse House version. If the result is another lazy deficit-boosting, hard-decision-avoiding scheme (like George Bush's rotten Medicare bill), what president would want to be remembered for that? Mr Obama remains an inspiring figure. But he needs to get his hands dirty this summer if he is to rescue a presidency that has started to slip.

America, Israel and Palestine

Get stuck in, Mr President

Jul 30th 2009
From The Economist print edition

After making a good start in the Middle East, Barack Obama must now get directly involved

Getty Images

THE American president may think he has enough on his plate without worrying about the dog's dinner simmering away in the corner: the sickly Middle East peace process, with its often nauseous ingredients. This week he has sent an array of colleagues to stir the pot, including his envoy, George Mitchell, who has been in and out of the region; Robert Gates, his secretary of defence; and Jim Jones, his security adviser, who knows the Palestinians from the past. But Mr Obama is the indispensable head chef. However preoccupied, it is he who must decide what to serve up—and when.

He has made an excellent start. His speech in Cairo to the Muslim world was masterly. He persuaded many Arabs and quite a few Palestinians that he was determined to be even-handed. And he squeezed Israel's new prime minister, Binyamin Netanyahu, into conceding for the first time in public, however grudgingly, that the Palestinians must have a state.

All the same, the outlook is still, on the face of things, exceedingly bleak (see article). Despite his two-state utterance, Mr Netanyahu sounds as obdurate as ever. Several of his advisers assume that the latest diplomacy will fizzle, leaving "fortress Israel" intact. If Mr Netanyahu refuses to stop all settlement-building on the West Bank, as Mr Obama is demanding, the Palestinians may then dig in their heels and refuse to resume talks. Mr Netanyahu gives the impression that he would not much care. His recent insistence that Jerusalem can never be shared makes negotiation even harder.

The immediate outlook on the Palestinian side is no rosier, mainly because of a bitter rift between the secular Fatah party, led by the Palestinians' hamstrung president, Mahmoud Abbas, who runs the West Bank, and the Islamists of Hamas, who run the Gaza Strip, still under an Israeli blockade. No deal with Israel will stick unless both Palestinian groups endorse it. Yet Hamas's refusal formally to recognise Israel makes it hard for a Palestinian unity government to emerge.

But all is not lost. The outlines of a deal have long been clear. The border of the two states must run close to that of 1967, with three big Jewish settlement blocks in the West Bank near the old line being taken into Israel, while the Palestinians are compensated with land swaps elsewhere. Jerusalem must be shared as the capital both of Israel and Palestine. And the Palestinians should get a symbolic right of return to the lands they lost when Israel was founded in 1948 while clearly accepting that in practice only a few of them will be able to resettle there. Ehud Olmert, Mr Netanyahu's predecessor, came close to a breakthrough on all three issues in talks with Mr Abbas last year, even without much American involvement. And on the Palestinian side, Hamas, despite its dogged ambiguity and divisions of its own, is not all that far from meeting the three conditions that would let it be brought into negotiations.

Even in the brightest circumstances, a full-speed peace process may not resume for months. The Palestinians' Fatah party is soon to have its first congress in 20 years, perhaps producing a better crop of leaders. And in January the Palestinians are due to have presidential and parliamentary elections that may—or may not—produce a new bunch of interlocutors for the Israelis. Until then, stalemate may prevail.

Just dive in

This is precisely why Mr Obama must soon get still more embroiled. Following his Cairo speech to Muslims, he should address the Israeli people directly, telling them why a Palestinian state is their only long-term guarantee of security. Ideally, he would also persuade Israel's government to lift its siege of Gaza, now that Hamas has, at least temporarily, stopped firing rockets at Israel. In return the leaders of the Arab world, including Syria (which he is rightly wooing), should be bullied into offering Israel tokens of good faith, such as permission for overflights and reciprocal commercial offices. They could also push much harder to help reconcile the two Palestinian groups—and, by the by, insist that Hamas unambiguously disavows violence and, at least de facto, says it accepts Israel.

Above all though, Mr Obama must soon spell out in detail his vision for the two states—and how it can be achieved. Building on the "parameters" laid down by President Bill Clinton in 2000, along with various other convergent scenarios such as the Arab League's initiative of 2002 and the unofficial Geneva Accords of 2003, he could delineate the contours of an agreement. It is not just that many Palestinians and Israelis would embrace this basic plan. At the moment politicians on both sides define themselves by the extremism of their most unreasonable opponents. With an authoritative Obama plan, both Israeli and Palestinian voters would have a new measuring stick. Mr Obama has begun to point the way. Now he must add the details and start banging heads together.

Japan's elections

Demolition men

Jul 30th 2009
From The Economist print edition

Breaking the mould of Japanese politics requires tackling the country's domineering civil service

Bloomberg

THE best thing about the new campaign manifesto of the Democratic Party of Japan (DPJ) is not what it says but that it exists at all. Voters in post-war Japan have been denied much of a voice by one-party politics. But on July 27th the opposition DPJ set out a "contract" with the electorate that it wants to be taken as a binding list of policies it will pursue if, as seems likely, the voters make history next month by breaking the Liberal Democratic Party's near-monopoly on power. Anyone who wants Japan to cast off its 20-year economic funk will welcome that. But the DPJ will succeed only if its leaders also take the next, bolder step—and scrap the country's "iron triangle" of lobbies, political barons and bureaucrats.

Barely a year ago the DPJ looked unfit to lead Japan. Its domestic policies were incoherent and unfunded, its foreign policy worryingly anti-American, its members an odd coalition of socialists and exiles from the LDP. All it had done since winning control of the Diet's upper house in July 2007 had been to block the LDP. Its then leader, Ichiro Ozawa, secretly plotted to form a grand coalition with the ruling party, lamenting that his own lot "lacked credibility".

Nothing sobers you up like responsibility. The DPJ has now backed away from some of its worst gimmicks. The manifesto unveiled by its new boss, Yukio Hatoyama, has sensible ideas, like cutting the elaborate system of state handouts and using a consumption tax to move the pension system away from companies, which the state shields from failure partly because of their role in dishing out social payments. Electing the DPJ is still plainly a risk: the party is inexperienced and, like the LDP, an improbably broad church. But it no longer looks foolish.

However, the DPJ will achieve little unless it also tackles Japan's fearsome bureaucracy. During decades of LDP rule, large parts of government were subcontracted to the civil service. Bureaucrats worked with powerful party bosses and industrial lobbies to set the agenda, flesh out policy—and neuter any reform that threatened their narrow interests. Even Junichiro Koizumi, the most charismatic and reform-minded of all the LDP prime ministers, struggled to get things done. With an electorate wary of rapid change and a system designed to frustrate it, Japan has rejected the reform it needs.

Reassuringly, the DPJ acknowledges the struggle ahead (see article). Its central promise in this week's manifesto is to show "the bureaucrats who is boss". But that calls for two things. The first is a combination of coaxing and courage. Coaxing because a new government will have to spot the bureaucrats who want reform (they do exist) and enlist their help. And courage because the system will fight back by spreading poison, just as it did the only other time the LDP lost power, for a brief 11 months in 1993-94, when civil servants colluded with their old bosses to discredit the new government.

Tokyo temptation

The second thing the DPJ needs is self-restraint. Its own people will be tempted to practise politics the old-fashioned way, by pulling strings outside the cabinet and working in league with the bureaucracy. Nobody is more dangerous than the former leader, Mr Ozawa—brilliant, unpredictable and a black belt in the dark arts of manipulation. The wisest thing Mr Hatoyama can do is to insist that his more impressive predecessor join the cabinet, where he should do least harm.

It is a tall order to expect the DPJ to reinvent the machinery of government overnight, or even in the four years it says it needs. But the party's reward would be great and the reward for Japan would be greater still: a two-party system that can at last begin to hold wayward politicians to account.

Commercial property

A concrete problem

Jul 30th 2009
From The Economist print edition

Banks face another round of property-related bad debts: this time it will be flashy offices, not rundown homes

THERE is something comforting about investing in bricks and mortar. To many people it is a solid, "real" asset, unlike those complex pieces of paper that flighty financial markets spend all their time trading.

But that very tangibility can lead to reckless speculation. Banks are almost always willing to lend against the security of property. The more they lend, the higher prices are driven. History is littered with stories of property crazes that ended in tears, from the Florida land boom of the 1920s to the recent subprime bubble.

After two years of pain, American house prices seem to be stabilising. But attention is now switching to the commercial-property market. Here too loans were bundled together to make complex securities, known as commercial mortgage-backed securities (CMBSs), on which defaults are now rising. And here too prices were driven higher by the use of borrowed money. Thanks to cheap finance, investors could use the time-honoured trick of covering the interest payments with the rental yield and hoping for capital growth on top.

Of this, there was plenty. IPD, an information group, calculates an index of global commercial-property returns. Between 1998 and 2007, this index trebled, easily outstripping the performance of the world's stockmarkets. And last year, while the MSCI World Index of global share prices suffered a negative return of 40.3%, commercial property lost just 10.1%.

The good news is that, in most developed markets, the boom did not result in a glut of new building. But the good news pretty much ends there. Vacancy rates are rising sharply and in some businesses, such as investment banking, demand for space may never reattain its previous peak.

The next shoe to drop

The aftermath of bubbles can last for a long time in financial markets. Wall Street has been celebrating the return of the Dow Jones Industrial Average to the terrain above 9,000. But it first passed that mark in April 1998. As with paper, so it can be with property. In Japan land prices are still nearly 60% below the peak they reached in 1991. Earlier this decade American homebuyers took false assurance from the oft-quoted fact that house prices had not fallen, at the national level, since the second world war; well, they have now. At the moment transactions have dried up in the commercial-property market as owners try to avoid selling at a loss. Those owners are implicitly assuming that a rebound is imminent, yet the downturn may be prolonged.

Such a downturn could inflict further damage on the banks. All the bad news may not yet be reflected on their balance-sheets; although they have had to take the hit on traded securities, like CMBSs, banks are usually slow to write down property-related loans. But as those loans come up for refinancing, losses will have to be taken unless owners put up more capital. Richard Parkus, an analyst at Deutsche Bank, reckons that American banks may eventually face $200 billion-$230 billion of losses on property-related loans.

Most of those losses are likely to land on small, regional banks, rather than the Wall Street giants that wobbled last year. That will still leave the American authorities with a dilemma if the losses prove potentially fatal. Will they allow banks to fail on the ground they are "too small to rescue", even if their failure would devastate the economies of the regions they serve? On the other hand, if they want to

rescue the banks, do regulators have the resources to cope?

This is a dilemma that will spread worldwide. The commercial-property downturn has a greater geographical spread than the residential bust. Prices and rents have already taken a hit in Asian financial centres like Singapore and Hong Kong, in developing economies like India and Russia and in European countries such as Spain and Ireland (see article).

The biggest danger may lie in refusing to acknowledge the scale of the problem. Some countries are awake to this: in Britain, where prices have fallen by nearly half in real terms, big property groups have raised equity to shore up their balance-sheets, and reduced prices are attracting foreign buyers to London. As the example of Japan shows, a short, sharp fall in prices is better than prolonged obfuscation and denial.

Torture and intelligence

Spies under the thumbscrews

Jul 30th 2009
From The Economist print edition

Torture, long a moral stain, is now hindering intelligence services' attempts to fight terrorism

Illustration by Gary Neill

SPEND time with spies on either side of the Atlantic—and you will discover that they are worried. That is partly because their profession, already sullied in recent years, may be hit by more bad news. In Europe the ordeal has already begun: an officer in Britain's MI5 is under police investigation, and prosecutors in Italy, Germany and Spain are looking at cases linked to the CIA's actions. In America, the centre of the problem, the spooks are preparing themselves for an onslaught that could be as bad as anything since the Church commission in the 1970s. There are hints of criminal investigations against CIA officials and a battery of lawsuits—to extract information and to claim compensation. But for the leading spymasters, there is an even bigger worry: they are finding it increasingly hard to do their jobs properly (see article).

The reason for all this? Torture. In the aftermath of the attacks on September 11th 2001, it became widely fashionable—in allegedly liberal parts of American academia as well as Dick Cheney's office—to argue that torture was a necessary part of democracy's defence. In fact, those who fought against that pernicious argument, including this newspaper, possibly underestimated our case. For all its short-term uses (both claimed and, alas, real), torture has always been illegal and immoral, and ultimately counter-productive too. Long before Abu Ghraib, it was obvious that it would create terrorists as well as help capture them. But the extent to which torture would corrode the West's security networks that are supposed to fight terrorism is only now becoming clearer.

Torture throws sand into the gears of intelligence. At first harsh interrogation may well yield information, both valuable and valueless. But over time it chokes the defences of democratic societies, because their courts and political systems cannot digest it. The work of Western intelligence is becoming gummed up with legal protocol. More information has to be vetted by lawyers before being passed on. America has warned Britain that intelligence-sharing will be curtailed if its secrets are divulged in court. Equally, many worry about what will emerge in American proceedings. The first lesson of the September 11th attacks was that intelligence agencies have to work more closely; "need to know" had to yield to "need to share". These days, alas, it has become "need to get a lawyer".

Would you tip off Pakistan?

Fighting a global network like al-Qaeda requires a global network of intelligence agencies. The information they swap should remain confidential, so as to protect sources and (legitimate) methods. But if judges, elected politicians and voters do not have confidence in their spooks, the system unravels.

The task is to restore trust. But how? In America Barack Obama moved quickly to ban the most abusive methods of interrogation and promised to shut the detention centre at Guantánamo Bay. He released four Bush-era memos which had twisted legal doctrine until it proved that CIA interrogators could simulate drowning, among other techniques, without turning themselves into torturers.

Mr Obama's stand against torture is a start. But the president and senior Republicans should reconsider their resistance to a "truth commission", which could offer some immunity from prosecution to those who speak openly. An investigation would disrupt the intelligence services—but less than lengthy court battles, which would fail to stop revelations yet still leave a suspicion that wrongdoing remains hidden.

The third step is to be readier to prosecute terrorists for their crimes. The struggle against terrorism will be long; in a democracy methods have to be sustainable. Legal process is not a luxury for good times, but a tool to rob terrorists of legitimacy and show that locking them up is justified. That way those who share the terrorists' religion or race are less likely to be silent accomplices. More could act as sources themselves.

Fighting terrorism will always be messy. Sometimes you have intelligence about an attack, but not enough evidence confidently to make an arrest; yet you don't have the luxury of being able to wait. Western spies inevitably have to work with the secret police of Pakistan, Egypt and others who often abuse prisoners, but also have more access to jihadists than the West ever could. Here, co-operation is a matter of wary judgment, not absolutes. For the West to refuse to deal with such countries would be as wrong as for it to put its agents in rooms where electrodes touch flesh. In between, lies the murky territory in which the West must not only trade intelligence, but must also seek assurances that people are not being abused. Ultimately, if those assurances are broken, the West will have to limit its co-operation with abusive intelligence agencies—even if that might make information harder to get. Do not forget, though, that al-Qaeda has been unable to attack America since 2001 and Europe since 2005. That is in large part thanks to legitimate intelligence co-operation, not torture.

Spain's happy-go-lucky government

When good politics is bad economics

Jul 30th 2009
From The Economist print edition

The prime minister's aversion to tough decisions risks prolonging the slump

EPA

AS SPAIN'S prime minister heads off for his summer holiday, he has some cause for satisfaction. Although his country is mired in recession, José Luis Rodríguez Zapatero stands out among the small band of centre-left heads of government in Europe because he has managed to keep his head more or less above the political waters (see article). Next door in Portugal, the socialist government looks headed for defeat in an election in September; so does Britain's Labour government next year. But Mr Zapatero's Socialist party has slipped only slightly behind the opposition People's Party, according to an opinion poll this week. Even if Mr Zapatero himself is less popular than he was, he still bests Mariano Rajoy, the plodding opposition leader. That is despite an unemployment rate that has shot up to 19%, double the average in the euro area.

In clearing his desk, Mr Zapatero pulled off a couple of deals that will shore up his position. First, he clinched an agreement over changes to the financing of Spain's autonomous regional governments (see article). This will give more money to Catalonia, and should earn him the backing of Catalan nationalist parties for the budget vote in parliament in the autumn. Without their support, the budget might bring down his government, since his party lacks a parliamentary majority. Second, he sided with the trade unions to block demands from business leaders to reform Spain's two-tier labour market. That has seen off the risk of a general strike.

For all their tactical political deftness, these agreements carry an economic cost for Spain. They are, alas, typical of Mr Zapatero's way of governing. By his refusal to countenance unpopular measures and his habit of showering public money on any problem, he risks prolonging the recession.

Spain's decade of growth has come to a painful end. In contrast to much of Europe, which is home to a few green shoots (see article), Spain's economy still looks as arid as the *meseta*. True, other European economies may contract more than the 4% decline the IMF forecasts for Spain this year (for that Mr Zapatero and his government's big fiscal stimulus deserve some credit). The problem is that the recession looks set to drag on much longer in Spain than elsewhere; many forecasters see no recovery before the end of 2010.

That is because Spain's problems stem not just from the global crisis, but from weaknesses at home. Its growth was based on low-skilled, labour-intensive industries such as house-building and tourism. Although 1m homes remain unsold, construction still accounted for 10% of GDP in the first quarter of this year—twice its share in Britain. Spain needs to use the time bought by deficit spending to reshape its economy.

An expensive, poorly educated labour force

That means reforming not just the dysfunctional education system but also the disastrous labour market. Mr Zapatero refuses “to cheapen the firing” of the two-thirds of the workforce on permanent contracts, who must be paid 45 days for each year of service if they are laid off. His refusal blunts the incentive to hire. Collective-bargaining rules mean that wages for the country’s labour aristocracy are rising even as prices are falling. Since Spain, a euro member, can no longer devalue, its businesses are becoming even less competitive.

An initially strong fiscal position is rapidly eroding, with the budget deficit heading for 12% of GDP this year. If growth remains elusive, investors will soon demand a higher return on the government’s bonds. But Mr Zapatero is spending regardless. Catalonia had something of a case for a bigger slice of the cake. But it looks as if the regional financing deal will add another percentage point of GDP to the deficit.

Mr Zapatero seems to be counting on inertia to pull his country out of its slump, allowing him to win a third term in 2012. He will be lucky to get away with it. Even if he does, it is a formula for the Italianisation of Spain. Put off the pain of reform now—and recovery will take longer. As Spaniards head for *la playa*, it is time their government told them so.

Economist.com OPINION LETTERS

On assisted suicide, the United Arab Emirates, American politics, Bolivia, honour killings, Afghanistan, Texas

Jul 30th 2009
From The Economist print edition

A matter of life and death

SIR – Your leader on assisted suicide assumes that it is "perfectly possible to frame a law that allows suffering people who are close to death to die quickly and peacefully, if they wish" ("Going gently", July 18th). However, the "safeguards" you describe actually illuminate the complexities and dangers of such a law. For example, you advocate a "waiting period" before dispensing lethal medication to ensure the desire for death is "settled". How would one define "settled"? And would we simply use units of time—minutes, hours, days or weeks—as a clear measurement of the sincerity of such a request? It is naive to imagine that a tangible landmark exists during this tumultuous waiting period that clearly separates an "unsettled" wish from a "settled" one.

You conclude that assisted suicide is problematic for very sick individuals who could expect to live for many years as "greedy relations will put pressure on the elderly to choose to die." Sadly, it is true that such a propensity can exist whether a relative is terminally ill or not. But it is not only avarice that motivates a wish for death; there is also the strain that caring for a sick family member brings, and the subtle coercion that can flourish under such pressurised circumstances. If one recognises that such human tendencies pose "too great a danger" for the non-terminally ill, then surely the terminally ill are entitled to equal protection under the law.

Lady Howe
House of Lords
London

SIR – You are right to say that legislation should not create risks for vulnerable people. Safeguards were built into Oregon's law and are enshrined in the proposed bill in Britain. So the obstacles to assisted-dying legislation are ideological, not practical.

Religious objections to assisted dying cannot, and should not, be resisted. Those with a deep conviction can opt out. Within the medical profession, resistance to assisted suicide represents a residual paternalism that has been discarded in other areas of care. Doctors need to consider the pressure that a population with increasing long-term chronic conditions places on health-care budgets. I would sooner be given the opportunity to make an autonomous choice about how my life should end than to feel coerced into making one as a result of rationing.

Dr Michael Wilks
Deputy chairman
Forensic medicine committee
British Medical Association
Winchester

SIR – Taking your views to their logical conclusion, why shouldn't every depressed teenager be allowed access to a lethal dose of barbiturates if they so choose? When people have embraced death, the traditional reflex has been to help them, to counsel them from their misery and to sustain their happiness so far as possible so that life may go on. Now, however, death is to be enshrined as a "right". This is individualism gone mad. No sane civilisation can allow itself to sit back and watch its people self-destruct.

Edmund Rogers
Barrie, Canada

SIR – Whose life is it anyway? Every competent adult who is not into suffering and that sort of redemption should be able to limit his or her pain, and have their companion of choice right there at the end. I do not want the government or religious dogma interfering with my choice.

Jerry Dincin
Highland Park, Illinois

SIR – In a society that puts a high premium on individual freedom, shouldn't all people, and not just the terminally ill, have the right to die when they want? Arnaldo Momigliano, a classicist, informed us that in the Greek colony of Massalia (today's Marseille), "Whoever wanted to commit suicide asked for authorisation from the senators; if his reasons were good, he was given hemlock free of charge." If such an option were on offer today, would more people be ready to engage confidently with life?

Elon Salmon
Barnard Castle, Durham

The United Arab Emirates

* SIR – The "big picture" in the United Arab Emirates is very different from what you portrayed in your recent article ("The perils of autocracy", July 11th). Relying on the opinions of some Western bankers and international credit-rating agencies is not the route to follow in assessing what the UAE is really experiencing. The subprime crisis and the ensuing meltdown of financial and economic stalwarts in the West come to mind. That is where massive "bail-outs" really occurred.

Autocracy is not necessarily perilous. One can argue that Singapore has been ruled, from its inception as an independent state, in a rather autocratic way, and the result has been far better than what was achieved by other states. In the UAE, although the rulers of each of the seven emirates has the final word in his emirate, federal government is a model of mutual accommodation and co-operation. It took Europe more than 50 years to establish the euro and to get its act together. For the UAE to have achieved what it has been able to do in the past 38 years is a real miracle.

May I also point out that the airports of Dubai, Abu Dhabi and Sharjah have each seen higher levels of traffic in the first half of 2009 than what they achieved in the first half of 2008, whereas most airports around the world have suffered declines. Furthermore, the UAE won the right to host the headquarters of the International Renewable Energy Agency, which will be based at the futuristic Masdar City in Abu Dhabi, beating off challenges from such countries as Germany and Austria.

The glory days of the Al Nahyan and Al Maktoum families, as well as the families of the rulers of each of the other emirates, are certainly not numbered, as you implied.

Fouad Bardawil
Chairman and president
Emirates Specialities
Dubai

Calling names

* SIR – I am outraged that you used the adjective "trashy" in reference to Sarah Palin's family (Lexington, July 11th). Why not apply it to the Kennedy name instead? Although perhaps the many affairs of JFK, the fatal promiscuity of Teddy and the various sex charges laid against William Kennedy Smith are more properly described as "sleazy". And, to give credit where it is due, the verbally challenged Caroline Kennedy did "find a less demanding line of work" rather than run for New York senator, even if no one went after her children.

As for your statement that people "assume that someone culturally similar to themselves will be more likely to look out for their interests", does this explain the monolithic support that African-Americans gave to Barack Obama in the election?

William Walker
Vero Beach, Florida

Politics in Bolivia

SIR – I take issue with several statements in your recent article on Bolivia ("The permanent campaign", July 18th). First, you describe the policies of President Evo Morales as "divisive". The president has a substantial democratic mandate for reform, gaining 54% and 67% of the vote in two elections. Opposition leaders are free to make their voices heard and challenge government decisions. Second, you refer to the imprisonment of Leopoldo Fernández, the ex-governor of Pando, but do not mention that Mr Fernández is implicated in a violent attack that resulted in the deaths of at least 11 people.

Third, the Bolivian government had nothing to do with the attack on the house of the former vice-president, Victor Hugo Cárdenas. The current vice-president, García Linera, issued a statement condemning the attack. Fourth, your mention of Venezuelan troops suppressing a rebellion at Santa Cruz airport in 2007 has no basis in fact.

Lastly, you said that the terrorists who were intercepted in Santa Cruz in April this year were "killed in their beds". The forensic police report of the incident shows that there was an exchange of gunfire before they were shot.

Beatriz Souviron
Ambassador for Bolivia
London

Honour killings

* SIR – The title to your article on honour killings in Syria asks: "The law changes. Will attitudes?" (July 18th). The answer is that it is easier to change laws than people's hearts. The primary reason honour killings still continue in the Muslim world is not that lawmakers have been unwilling to pass legislation imposing punishments for such acts, but because imams, muftis and ayatollahs not only have never condemned the practice but have actually sanctioned it.

For instance, the "Umdat al-Salik", a manual on *sharia* law, states that "retaliation is obligatory" against anyone who kills, except when "a father or mother (or their fathers or mothers)" kill "their offspring, or their offspring's offspring". Therefore, someone who kills his or her child for the sake of "honour" incurs no penalty under Islamic law.

A similar situation arises with female circumcision. It is still widespread in Egypt despite an outright ban because Muslim clerics condone the practice as in accordance with mainstream Islamic tradition.

So it is not enough simply for human-rights advocates to call for a "more fundamental change in the attitudes of those who write the law and implement it". There must also be an open discussion about the Islamic roots of practices like honour killings and a call for authorities on *sharia* to renounce the sanctioning of honour killings and to teach why such killings are wrong in the context of a reformed interpretation of Islamic texts. Otherwise attitudes simply will not change, and honour killings will continue in the Muslim world and among Muslim communities in the West.

Aymenn Jawad
Cardiff

Afghanistan

* SIR – America and its allies won the war in Afghanistan six years ago, when they crushed and dismembered a mostly foreign al-Qaeda that had set up shop in that country. Al-Qaeda was and should have remained the only direct target of the war. Like the empire-minded American government at the time, however, The Economist does not grasp that there is no sustainable, added value of expanding the war against the local-born Taliban nest in which al-Qaeda embedded itself at the time ("Hold your nerve", July 18th).

You resort to McNamara-style rhetoric to rally the troops, threatening us with the "utter destabilisation of nuclear-armed Pakistan" and the "emboldening of every jihadist in the world," if we "lose heart" and fail to pacify a nation that does not have the heart to pacify itself.

We have sacrificed enough in attempting to help the more secular-minded people in Afghanistan to help

themselves. What we need now is a surge of foresight and rationality, not propaganda. America and its allies will not lose the war in Afghanistan if we extract ourselves from the unachievable task that we have laid at the feet of our military.

Roger Brewer
Honolulu

The state of things to come

SIR – I enjoyed your leader contrasting Texas with California ("America's future", July 11th). But you set up a false choice. America's future is best secured by balanced public spending and the ideal is a middle course. California spends way too much. State and local spending per person is 12% above the national average, although its higher-education system is the envy of the nation. Texas spends way too little, 17% below the national average, and has a weak education system. Its health and human services are among the poorest in America.

If spending in Texas was at the national average the state could spend $23 billion more a year on education and human services. With that kind of money, plus the federal matching dollars it would bring, Texas could have several first-rate universities, strong public schools and community colleges, and health and human services that aren't an embarrassment. For a prosperous future, you don't want to be California or Texas. You want to be between the two.

Bill Hobby
Lieutenant governor of Texas, 1973-91
Houston

SIR – Yes, California is currently a mess, but this is attributable to rigidly ideological politicians in Sacramento and one rigidly ideological former president, ironically, a Texan.

Will Bruzzo
Orange, California

SIR – Texas's high-school exam still flunks an appalling number of students despite efforts over the years to lower standards and make passing easier. I took the test three years ago. One page showed a map of the Long March in China, with a massive arrow indicating where Mao and his men moved through the countryside. The accompanying question did not test students' knowledge of Chinese history, but asked, "Which end of the arrow symbol marks the destination and which end of the arrow marks the beginning?"

Brian Reinhart
Houston

* SIR – I'm surprised that your special report on Texas (July 11th) attributed the state's long-term hopes to low taxes and light regulation. California's Proposition 13, which passed in 1978 and drastically lowered taxes, was the start of that state's budget problems. And deregulation ushered in the electricity blackouts that led to the recall of Gray Davis as governor in 2003.

Robert Gardiner
San Jose

* SIR – Although my many friends in Texas will probably disagree, on a range of factors such as humidity, natural beauty, cuisine, progressive thinking and flying insects, California bests Texas by a mile. This is why, no matter how fractured our governance, crowded our freeways or beaches or high our taxes, some of us wouldn't return to live in Texas for all the oil in the Permian basin.

Kevin Patrick
Del Mar, California

* SIR – I grew up in Houston and still have family there. You implied that a city that has the space to sprawl over hundreds of square miles and no zoning restrictions has an advantage. I can tell you that Houston is probably one of the ugliest, most anti-pedestrian and environmentally unfriendly cities in the Western world. Crass advertising is plastered absolutely everywhere. You rarely see any living creature

on the pavements outside downtown during business hours. The city’s miles upon miles of petrol-choked roads determine its geography.

I think that hell might even be more interesting than Houston. They are certainly comparable temperature-wise.

Andrew Swearingen
Oxford

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* Letter appears online only

Spies, torture and terrorism

The dark pursuit of the truth

Jul 30th 2009
From The Economist print edition

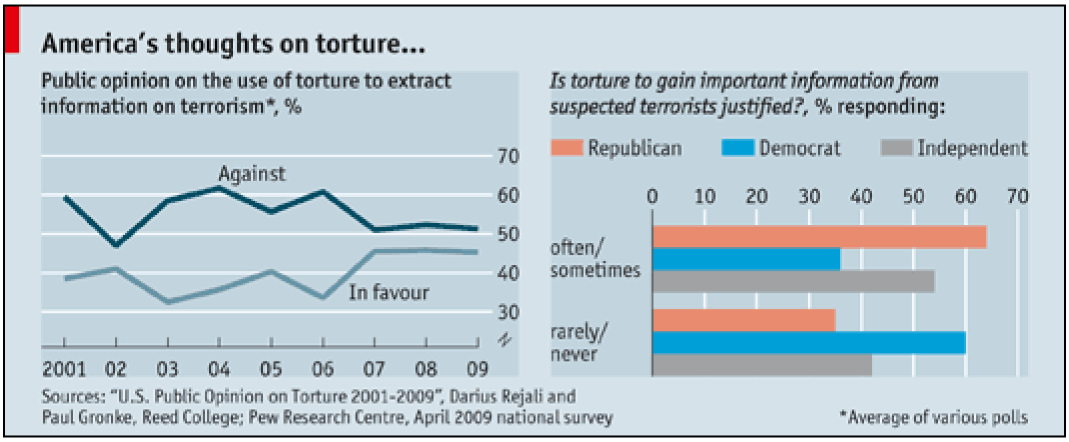
Torture still casts a long shadow in the battle between spies and terrorists

Illustration by Gary Neill

JACK BAUER famously does whatever it takes to save America from disaster, be that disaster nuclear, biological or computer attack. Week after week, the hero of "24" acts brutally, and endures brutality, for the greater good. It is a sign of the times that this year's season opened with Bauer being hauled before a congressional committee to face the charge of committing torture. He was unrepentant.

This television character, who first appeared in 2001, has been oddly at the heart of the arguments over the conduct of America's "war on terrorism". Critics in the American army have complained that he encourages young soldiers to abuse prisoners. Supporters, such as Antonin Scalia, a Supreme Court justice, praised him for the episode in which he saved Los Angeles from nuclear attack, even though it meant staging the mock execution of a family to get a Middle Eastern villain to talk. "Is any jury going to convict Jack Bauer? I don't think so," said the judge.

In contrast with Europeans, who strongly reject the use of torture, the American public is pretty evenly divided about its use to extract information from terrorists (see charts). But President Barack Obama, for one, is clear. No sooner had he been sworn into office than he banned torture, rescinded legal opinions allowing simulated drowning and other harsh methods, ordered all American agencies to comply with the army's field manual on interrogation, announced he would close the prison at Guantánamo Bay within a year and ordered a series of policy reviews on detention and interrogation. "From Europe to the Pacific", Mr Obama said in May, "we've been the nation that has shut down torture chambers and replaced tyranny with the rule of law." Dick Cheney, George Bush's vice-president, sneered at such talk as "recklessness cloaked in righteousness".



Many people thought that Mr Obama's election would finally settle the controversies about counter-terrorism's "dark side" (as Mr Cheney once put it); a darkness that concealed secret prisons, abusive interrogation and "rendition" to countries that practise torture. The distorted DIY legal framework that treated suspected terrorists as neither criminals nor prisoners-of-war, leaving them in an unprotected grey zone between civil and military law, would, many liberals hoped, be put right.

In April, against the wishes of current and former CIA directors, Mr Obama released four secret memos from the Department of Justice, written in 2002 and updated in 2005, that made legal the CIA's use of "enhanced" interrogation techniques such as the use of the "waterboard" (simulated drowning), sleep deprivation, "walling" (hurling a prisoner against a partition wall), "stress positions" and strange practices like placing a "high-value prisoner" in a cramped box with an insect to exploit his phobia about bugs. It revealed that one prisoner, Khaled Sheikh Mohammed, the operational head of the September 11th 2001 attacks on America, was waterboarded 183 times.

Mr Obama said that he did not want to prosecute those who operated within these rules. He knows that if he takes action against interrogators he could be accused of seeking scapegoats; if he goes after the CIA chiefs he would be charged with undermining America's security; and if he investigates leaders of the Bush administration he would look as if he were conducting a witch-hunt against his political rivals. "Nothing will be gained by spending our time and energy laying blame for the past," he argued.

Yet the past casts a long shadow. Some of Mr Obama's supporters want a "truth commission" to establish what happened and, perhaps, recommend prosecutions. Congress is incensed that the CIA did not tell it of a secret programme (which may have had to do with the assassination of terrorists), apparently under orders from Mr Cheney, bringing the former vice-president a step closer to formal investigation. The attorney-general, Eric Holder, is thought to be about to appoint a special prosecutor to investigate those interrogators who exceeded the already lax limits set by the so-called "torture memos".

Even before this, CIA officials had been hiring lawyers in anticipation of trouble. Some of Mr Obama's favourite spooks have been unable to take up senior appointments because of their association, sometimes only peripheral, with the interrogation programme. John Brennan, a veteran CIA figure, was withdrawn from consideration as the agency's director and was given a job in the White House instead. Philip Mudd, a respected intelligence man currently on secondment to the FBI, pulled out of his nomination to the senior intelligence post in the Department of Homeland Security. The Obama administration may have chosen these men but it put little effort into backing its choices.

The big chill

How will all this affect future intelligence operations? There is a distinct chill. Some reckon that the CIA and other agencies face their worst crisis since the post-Watergate inquiries in the 1970s uncovered evidence of spying on Americans and plots to assassinate foreign leaders. "There is undoubtedly some nervousness," says one senior source. "It does not stop you taking action, but it makes you think twice and talk to your lawyer."

Britain's close relations with America are causing it similar problems. Its intelligence agencies are being dragged into the legal limelight, not for torturing suspects but for allegedly colluding in their maltreatment by others—whether they are Americans, Pakistanis or Moroccans. One member of MI5, Britain's domestic intelligence agency, is under police investigation.

Increasingly lawyers are being brought in to scrutinise British intelligence before it can be passed on. Will handing over the name of a suspect to America lead to him being killed by an unmanned aircraft in Pakistan? Will sharing a telephone number with, say, Egypt's spies, lead to the arrest and torture of somebody who should instead be merely watched? Will submitting questions to be asked of a man held in a foreign prison mean that British agents will be held responsible for his treatment?

Agents have become warier of questioning detainees abroad for fear that they will be blamed for any abuse they may have suffered. The number of requests by officials in MI6 (Britain's foreign intelligence service) for the legal cover known as "Article 7", in which the foreign secretary approves actions that are illegal in Britain, has shot up.

Many of the woes of British agencies are embodied in the case of Binyam Mohamed, an Ethiopian asylum-seeker in Britain, who gave up his drugs habit after rediscovering Islam. He went to Taliban-ruled Afghanistan to see an Islamic state at work. There he underwent some form of military training—to help the resistance in Chechnya, he says, not to fight the Americans. He was arrested trying to leave Pakistan in 2002 on a forged passport. He was beaten in prison, where he was seen by members of the FBI and MI5. He was then taken by the Americans to Morocco, where he says he was tortured by a questioner called Marwan, who took a sharp blade to his chest and penis while asking questions that had plainly been fed to him by MI5.

The British authorities say that once Mr Mohamed had left Pakistan, they did not know his whereabouts or conditions of detention; all questions were submitted through the Americans. Much of America's programme of secret detention and interrogation was formally hidden from allies. The top-secret "torture memos" were classified "NOFORN" (no foreign nationals). But stories of prisoners being abused by the Americans were already circulating in 2002. Indeed some British officials had expressed concern at what they saw.

It was under torture, Mr Mohamed says, that he admitted to meeting Osama bin Laden and to taking part in plots including the detonation of a dirty bomb. This is what he would be accused of when he got to Guantánamo Bay in 2004, via a secret prison in Afghanistan. But, like many others, Mr Mohamed was released in February this year without charge.

By then Mr Mohamed's lawyers, among them Clive Stafford Smith, founder of a legal charity called Reprieve, had been in full swing on both sides of the Atlantic. They sued the British government to release documents that might prove Mr Mohamed's innocence, obtaining a High Court judgment that was critical of MI5 and led to the police investigation of one of its officials, known only as "Witness B". In a parallel case in America, Mr Mohamed and other Guantánamo inmates are suing Jeppensen DataPlan, a subsidiary of Boeing, which allegedly provided aircraft for the CIA's rendition programme.

Mr Mohamed's release has not stopped the litigation in either America or Britain. Both governments argue that the lawsuits should be thrown out because state secrets cannot be divulged. Indeed, the Obama administration has warned Britain that intelligence-sharing would be jeopardised if secret information provided by the CIA were to be revealed in British courts. Similarly, officials in Britain are alarmed by what may be disclosed in America.

Waterboarding the agencies

These days it is the intelligence agencies that find themselves under interrogation. Each snippet they provide produces requests for more information. And the courts, suspicious of what the agencies may be hiding, are demanding ever more disclosure. One source of information has been the succession of freedom-of-information requests for official documents, including the "torture memos", by the American Civil Liberties Union (ACLU).

Legal campaigners are waging an information-gathering effort that earns the grudging respect of intelligence operatives. "They are chasing the paper trail and winning," says one. "They are chipping

away at state-secret privilege [the doctrine that courts can dismiss lawsuits if classified information will be released]. They could disclose an awful lot of information—names of interrogators and medical personnel. If secrets start seeping out, countries that have been sharing information may be disinclined to do so.”

The controversies show the extent to which torture and other forms of harsh interrogation—even though they may have been abandoned—cloud the legitimate work of counter-terrorism. American sources say that in the latter years of the Bush administration, European agencies, worried that they might be caught up in America’s abusive practices, became reticent about sharing intelligence. Today, America’s partners may hold back out of fear that America will not be able to protect their information. Officials lament that the machinery of Western intelligence-sharing is becoming “gritted up”—though information about “life-threatening” plots is still swapped briskly.

Intelligence-sharing is vital. America, with its vast resources, has become the main repository of information on global terrorism. Though Britain has well-regarded intelligence services, it obtains more than half its reports on terrorism from other agencies, principally American. And about half of America’s intelligence reports on al-Qaeda until 2006, says a former senior official, came from detainees.

The Justice Department’s memos were prompted by the arrest in 2002 of Abu Zubaydah, a man with close links to al-Qaeda. The CIA wanted clearance to exert greater pressure on the first of its “high-value detainees”—even though FBI investigators would later claim that Mr Zubaydah was already talking freely.

Degrees of pain

The memos gave the CIA licence to use “enhanced” techniques derived from American training advice to pilots and other personnel on how to withstand torture if they should fall into enemy hands. They are shocking for their bureaucratic punctiliousness. They parse the degrees of pain that would constitute forbidden torture (“an intensity akin to the pain accompanying serious physical injury”). They set out in incongruous detail the limits of abuse.

A prisoner could be deprived of sleep, but for no more than 180 hours before being allowed to rest for eight. He could be stripped naked but only if the room was warmer than 68°F (20°C). He could be doused in water but it had to be potable. He could be waterboarded with cold (saline) water poured onto his face but each application should not last more than 40 seconds, there should be no more than six applications per session, no session could last more than two hours and there could be only two sessions in 24 hours.

The ACLU’s next target is a comprehensive and still largely secret internal CIA report written in 2004 by John Helgerson, then the agency’s inspector-general. This is believed to be particularly damning, providing evidence of abuse that went well beyond the permitted guidelines. Compared with the antiseptic legal memos, writes Jane Mayer, the author of a book called “The Dark Side”, the Helgerson report is a “Technicolor horror show”, including accounts of people who died in custody. A version of the report, so heavily redacted with black deletion marks as to be barely comprehensible, was released in 2008. A more complete version is expected in the coming weeks, although the Obama administration has asked for delays.

Illustration by Gary Neill

Crucially, the report is critical of the value of the information obtained through harsh interrogation. It apparently concludes that there is no evidence that such intelligence prevented any imminent attacks. But this argument was strongly contested by the Bush administration.

Michael Hayden, the CIA’s director from 2006 until earlier this year, wrote in April that enhanced interrogation had led the agency from one big fish to another. Abu Zubaydah, he says, was forced to give information that led to the capture of Ramzi bin al-Shibh (one of the planners of the September 11th attacks); he, in turn, helped lead to the capture of Khaled Sheikh Mohammed (which, the memos claimed, foiled a “second wave” plot to crash an aircraft into Los Angeles). Mr Hayden said that of the thousands of people captured as “unlawful combatants”, fewer than 100 were held under the CIA’s interrogation programme and fewer than one-third of those were subjected to the “enhanced” techniques set out in the memos. Just three people were waterboarded. This, however, ignores all manner of abuses committed in

military prisons.

That there was no follow-on attack on America after September 11th was thanks in large measure, argues Mr Cheney, to the Bush administration's policies, including the enhanced techniques. Though he denounced the release of the memos that allowed these methods, he now wants further documents to be published that would, he says, demonstrate their success.

People familiar with the inner workings of intelligence suggest a more ambiguous story. Intelligence, they argue, is about piecing together fragments of information and building up spider diagrams of connections between suspects. "Intelligence is grains of sand; you don't usually get the whole beach," says one veteran.

It is true that in 2001, a time when the CIA and other agencies were woefully ignorant of al-Qaeda's methods, the prisoners captured after the overthrow of the Taliban were the first rich source of information to help "map the enemy", as one intelligence source puts it. But, says a former counter-terrorism official, the most valuable information from Mr Zubaydah's capture came not from his interrogation but from his address book. With Mr Mohammed, says another analyst, the most important factor in stopping further attacks on America was not what the terrorist said under duress, but that he had been captured in the first place.

Intelligence officials maintain that detainees under interrogation provided as many, perhaps more, specks of information as other sources of intelligence on terrorism, including signals and agents. The question that nobody can answer is how much of this could have been obtained without torture.

Bleak choices

The danger for Mr Obama, as he seeks to overhaul the intelligence system, is that a fresh attack on the American mainland would immediately expose him to the accusation of being soft on terrorism. In May Congress revolted against any attempt to move detainees from Guantánamo to American soil before a plan for the disposal of its 229 prisoners had been drawn up. Yet three task-forces examining the matter, including future policy on detainees, have delayed issuing their reports because of the complexity of the problem.

Mr Obama has decided to keep the reviled military commissions, albeit with reforms. And he may yet seek a form of indefinite detention for some prisoners, with judicial and congressional oversight. Lurking in the background are the lesser-known problems of America's prison at Bagram, its main base in Afghanistan, where detainees are being held with much less scrutiny than those at Guantánamo.

Holding terrorism suspects has become a huge headache for America. One fear is that if, in future, it tracks down important al-Qaeda figures, it may prefer one of two bleak options: either turn them over to countries with far fewer qualms—or just drop a bomb on them. Jack Bauer would be delighted.

Health reform

What now for Obamacare?

Jul 30th 2009 | NEW YORK
From The Economist print edition

The president's plan to overhaul America's health system hits turbulence in Congress

AP

"IT'S a lot easier to be Santa than Scrooge," harrumphs Jim Cooper. The congressman from Tennessee is complaining about the health-reform plan unveiled in July by the Democratic leadership in the House of Representatives. He thinks it is a populist initiative that will end up fuelling rather than curbing America's runaway health inflation. Such tough talk would not be in the least surprising coming from the opposition party; but Mr Cooper is a Democrat. And he insists that reform efforts have gone so badly wrong that it is time to "go back to the drawing board".

Health reform is the domestic priority for Barack Obama, who has been pushing both houses of Congress to come up with final health bills before the August recess. On current plans, the House of Representatives is supposed to wind up its session on July 31st, while the Senate is scheduled to stay at work one more week.

A few weeks ago, it had seemed that his efforts were working, as both chambers were making progress on health legislation. But after months of building up momentum, Obamacare has hit serious snags, and Mr Obama's deadline looks likely to be missed. Whether this merely delays reforms until the autumn or scuppers them altogether remains to be seen.

The health bill supported by the House leadership quickly won approval from two of the three relevant committees, but then got bogged down in the Energy and Commerce committee. That is because Mr Cooper and half a dozen like-minded fiscal conservatives (all part of the "Blue Dog" coalition of Democrats, see article) threatened to keep it from advancing to a vote by the entire chamber. On July 29th the Blue Dogs agreed to stop blocking the committee's work if the party leadership agreed to various changes in the draft bill, including a cut in spending of some $100 billion, and to a delay in the final House vote until after the recess.

What then? Nancy Pelosi, the House Speaker, declared recently "When I take this bill to the floor, it will win." Hang on a minute, though. Just because the House leadership forged ahead in crafting a bill before the Senate did does not mean it is a good bill or that it will get through. The highly partisan effort, which contains provisions for a government-run insurance plan and tax hikes for the rich, was always going to have a hard time winning broad support. Mr Cooper is convinced that Ms Pelosi does not have the votes in her own party necessary to pass the bill as it stands.

Moderate Democrats are reluctant to pin their names to a bill that conservatives are branding as big government and anti-business. The House proposal has also been criticised by non-partisan outfits including the Mayo Clinic, a respected hospital chain. The Congressional Budget Office (CBO), an independent agency, suggests it does not do enough to curb costs.

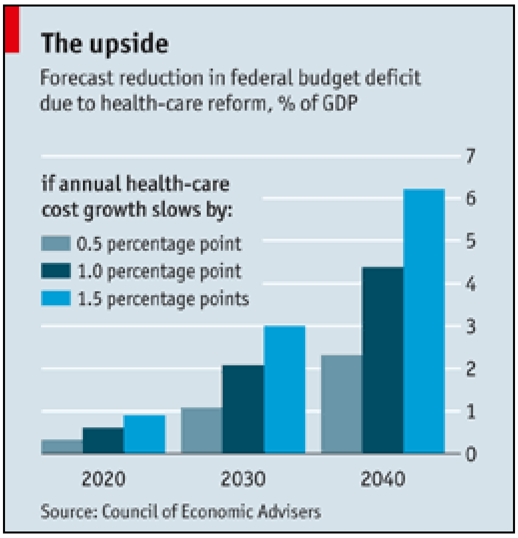
Small businessmen are also upset about the House bill's "employer mandate", which requires most firms to provide health coverage or pay a hefty fine. Nydia Velázquez, the Democratic chairwoman of the House's committee on small business, complained on July 28th that this was an unfair burden. The deal announced by the Blue Dogs the next day acknowledged this concern by raising the threshold below which firms would be exempted from the mandate.

This in-fighting is reinforced by the fact that Democrats do not yet know whether a more appealing compromise that meets the test of revenue neutrality laid out by Mr Obama may yet emerge from the other chamber of Congress.

The Gang of Six at work

At first blush, it seems the Senate is lagging far behind the House. The Senate's health committee has passed a highly partisan bill, but the more important Finance Committee has yet to do so. And the Senate's Democratic leader, Harry Reid, has already admitted that he cannot bring a bill that merges the output of those two committees to a vote by the full chamber until the autumn.

Yet it is the Senate Finance Committee that still offers a chance for sensible and successful health reform this year. That is because the committee's boss, Max Baucus of Montana, has pursued an impressively bipartisan approach. He has formed a core group, comprised of three senators from each party; its members have been meeting for hours a day for many weeks to hash out a compromise.



There was no final deal ready as *The Economist* went to press, but one could well come very soon. Chuck Grassley, the ranking Republican on the committee and a member of this powerful Gang of Six, reports that his group is "making progress by inches". He defends this painstaking process as a "more careful and less partisan" approach than the one taken by the House or the Senate's health committee. That is a big boast, but he is right.

The working group has courageously rejected several reform proposals popular with senior Democrats (including the president) and is considering including other measures that are unpopular with influential lobbies. If these bold ideas make it into the group's final compromise the Gang of Six may yet come up with a version that will win strong bipartisan support and form the backbone of any final reform bill.

The working group is edging towards rejecting two shibboleths of the left, both present in the current House proposals: a public plan and an employer mandate. Mr Obama has banged on about the need for a government-run insurance scheme to compete against rapacious private insurers, but moderates argue that reforming private insurance markets (as other countries including Switzerland and the Netherlands have done) offers a better solution. Labour activists have demanded a "pay or play" provision that would force companies to pay a hefty fine if they did not offer coverage, but many economists think such a provision would end up taxing low-skilled workers and destroying jobs.

The right ideas, at last

AFP

Just as important is what the group appears to be putting back into the mix. Many experts think capping or ending the tax advantage enjoyed by employer-provided health cover is a vital reform. Not only could it raise up to $250 billion a year but it would also fix some perverse incentives. Unions, whose members often enjoy

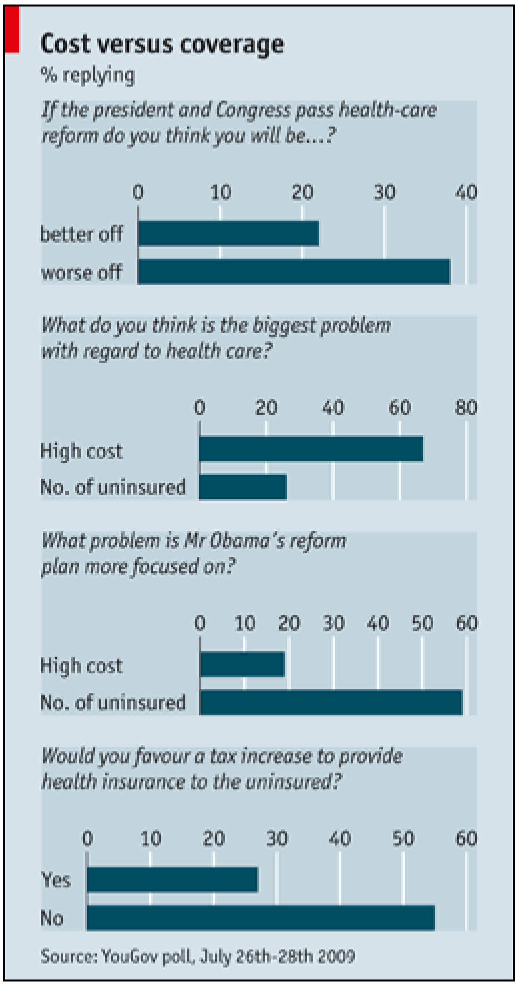
overly-generous health plans, hate this idea, and Mr Reid told Mr Baucus last month to kill it. Mr Obama roundly denounced the idea on the campaign trail.

Baucus (left) and Grassley hatch a plan

Happily, this virtuous notion has resurfaced in different form and now has "viability" in the Finance Committee, according to Mr Grassley. Senator John Kerry has proposed a tax on the costliest health plans sold by insurance companies. The insurance lobby grumbles but misses the point: this proposal is meant to discourage only extravagant plans that prompt overuse of health care. Though not as elegant as a direct cap on the tax exclusion, this proposal is both a big step forward and politically palatable. Peter Orszag, director of the White House's Office of Management and Budget, confirms that the Obama administration is "open to this idea", and Mr Cooper also thinks it is promising.

The Gang of Six also appears to be taking up another good idea that had nearly fallen by the wayside. Last month the White House proposed the creation of an Independent Medicare Advisory Council (IMAC) to tackle costs and improve quality in Medicare, the government health scheme for the aged. The idea is that this non-partisan group of experts would make recommendations to the president twice a year, and he would be required to accept or reject them as a package. If Congress did not reject the package within 30 days the proposals would come into force.

A poll conducted this week for *The Economist* by YouGov underlines the potential importance of this step. Voters (see chart) overwhelmingly care more about the cost of health care than about the beloved Democratic goal of achieving near-universal coverage. So far the administration has focused too much on the latter.



The IMAC approach has the virtue of shielding difficult decisions about cost cutting from petty politics. Such an approach worked well when used by the Pentagon to decide which military bases to shut down. But an earlier and softer version of this idea, known as MedPAC, flopped. Nancy-Ann DeParle, the White House's head of health policy, served as a commissioner at that agency. She recalls that Congress simply ignored many recommendations that proved politically inconvenient.

So the idea of giving such an agency teeth should be welcome. Mr Orszag argues that it has two big merits: it insulates tough decisions from politics and it encourages ongoing rather than one-shot reform. Alas, the IMAC idea hit a snag on July 25th when the CBO insisted that it would not save much money over the next ten years. Among the shortcomings the agency identifies is the fact that the IMAC proposal does not contain specific cost-cutting targets or "triggers" that would act to cut costs automatically.

Why did it not? If IMAC were to get real clout, many Democrats fear that the Republicans would try to paint it as an effort to "ration health care". That points yet again to the importance of the bipartisan approach taken by the Senate Finance Committee. Such an approach might even lead to other important reforms making it onto the table. Mr Cooper is hopeful that tort reform will make it as a "last-minute sweetener", and an influential senator, Ron Wyden, says other innovative ideas from an excellent earlier bill he proposed are now getting a "second and third look".

Whether the Gang of Six reaches an accord before the recess or after matters less than the eventual outcome. Of course, it may all go horribly wrong in the end, dooming Obamacare altogether. A good Senate bill will be hard to reconcile with a bad House one. Mr Grassley, though, is confident that the Senate version will prevail. This is a gang worth watching.

Blue Dog days

Jul 30th 2009 | WASHINGTON, DC
From The Economist print edition

Conservative Democrats are making the weather

Illustration by Claudio Munoz

AMERICA'S capital, filled with politicos and pundits, is a noisy place. But the howls of one group have risen above the rest. The "Blue Dogs", a group of 52 fiscally conservative Democratic congressmen, have been at the centre of the fight over health care, after threatening to torpedo the climate-change bill in June. Barack Obama invited a group of them round to the White House on July 21st. Henry Waxman, chairman of the House Energy and Commerce Committee, wooed them with a bouquet of compromises. On July 29th Blue Dog leaders managed both to win a deal and humiliate Nancy Pelosi, the House Speaker. Their delay is likely to prevent her from bringing the bill to a full vote before the August recess.

The Blue Dogs' evolution has proceeded in fits and starts. After the Republicans seized Congress in November 1994, a group of mostly Southern Democrats formed a coalition to distinguish themselves from their own party liberals. They said they were yellow-dog Democrats (a traditional Southern term for a loyalist who would vote for a yellow dog so long as it was a Democrat) "choked blue" by their leaders. Their main goal has been to resist the tax-and-spend policies too often pushed by their party's barons; their home-page features a federal debt clock that on July 30th stood at $11,226,807,380,955.11. But for much of the past 15 years they have been a marginal force.

Since 2006 the Blue Dogs have enjoyed a new era of influence. They helped swing the House to the left—11 Blue Dogs seized Republican seats in 2006 and a further five in 2008. Since the start of this year, without the threat of a Republican presidential veto, their clout has grown. Contributions to the Blue Dogs' political action committee look set to break previous records, according to the Centre for Public Integrity, based in Washington, DC. Charlie Stenholm, a former congressman and founding Blue Dog, contends that "this is the first year for the new kennel in which their votes are really going to make a difference." A victory came on July 22nd, when the House passed a bill requiring any new spending or tax cut to be offset elsewhere. The debate over health care, however, may be the pinnacle of the group's power so far. Seven Blue Dogs on Mr Waxman's committee refused to let a bill proceed without more measures to contain costs.

Despite all this, the Blue Dogs' grip on power is far from secure. The group does not always vote as a block. Its members, hailing from swing districts, are inherently vulnerable. What is more, some say their centrist role is overstated. The Blue Dogs are more conservative than average Democrats, but their voting record is closely aligned with their party nonetheless, according to a study by Burdett Loomis of

the University of Kansas. Only 12 voted against a bail-out of the car industry last December. Only ten voted against the stimulus bill. Robert Borosage of the Campaign for America's Future, one of many critics on the left, thinks the Blue Dogs bend their ideology when it suits their district, be it a rural area or one dependent on coal.

Nevertheless, the Blue Dogs are carving out a distinct role in a partisan era. Congress has become much more polarised since the 1960s, according to an analysis of party votes by James Thurber of American University. "Partisan extremism has meant that the vast majority of Americans feel unrepresented," argues Jim Cooper, a Blue Dog from Tennessee. Blue Dogs, he says, provide a voice of moderation. For now, at least, the group has the attention of the White House, party leaders and the media. The dogs are having their day.

Crime and exoneration

Hidden evidence

Jul 30th 2009 | NEW YORK
From The Economist print edition

DNA is changing the way America fights crime, not its policies towards convicts

A JUDGE can tell prospective jurors that in a criminal trial, unlike an episode of "CSI: Crime Scene Investigation", scientific evidence is not necessary to secure a conviction, an appeals court in Baltimore ruled on July 7th. Quite right, too. The evidence submitted in real courts is often not as cut-and-dried as it seems on television. Yet the use of DNA to secure convictions is growing fast. The people not benefiting from this are those who may have been wrongfully convicted before DNA was routinely examined, and who are being denied access to evidence that could set them free.

Much is being made of a recent Supreme Court ruling that William Osborne, a prisoner in Alaska, has no constitutional right to DNA testing to prove his innocence of the 1994 rape for which he was convicted and jailed. Nina Morrison of the Innocence Project, a New York-based non-profit legal outfit that represents Mr Osborne, fears the decision could lead to many innocent prisoners remaining in jail—or even facing execution.

Since Congress passed the DNA Fingerprint Act in 2005, federal authorities have been collecting DNA samples from everyone they arrest or detain. The FBI's national DNA database (NDIS) gets more than 1m DNA profiles a year. By last May CODIS, an FBI index that compares forensic evidence at local, state and national level, resulted in 90,900 "cold hits", where biological evidence from an unsolved crime matches a profile in the database. This has led to many arrests and convictions.

But three states (Alaska, Massachusetts and Oklahoma) give prisoners no statutory rights to a DNA test, even though such a test might exonerate them. Though exonerations have occurred in Massachusetts and Oklahoma by way of appeals from defence attorneys, access to testing is still hard to get. Many other states allow testing only in limited circumstances. Kentucky, for instance, restricts its DNA testing to death-row inmates. Someone serving a life sentence is not eligible.

Texas and Illinois, whose laws do permit simple post-conviction access to testing, boast the highest number of convictions that have been overturned thanks to DNA evidence: 38 and 29 respectively, says the Innocence Project. Texas, which accounts for half of all executions in America, passed a bill in May establishing the Timothy Cole Advisory Panel on Wrongful Convictions, named after a man posthumously exonerated through DNA testing. A team set up to study the causes of wrongful convictions and to devise ways of preventing them is to report to the governor no later than 2011.

Prosecutors can use their state's statutes of limitations (which set time limits for the introduction of new evidence after sentencing) to decline prisoners' requests for DNA testing. They argue that cases could be strung along endlessly and expensively by frivolous appeals if there are no such limits. Yet this seems a weak argument when it comes to DNA, which might establish innocence or guilt without much scope for prolonged debate.

Many prisoners might be cleared were DNA testing more routinely available. The American legal system encourages plea bargains, whereby accused people accept a much lower sentence than would be imposed if they were found guilty. In the absence of the DNA evidence that would clear them, even innocent people may conclude that a plea bargain is the safer option. More than 90% of convictions in the United States result from such bargains.

Steven Benjamin of the National Association of Criminal Defence Lawyers contends that the restrictions on post-conviction testing amount to a fear of the truth. He may be right.

Criminal justice

Room service not included

Jul 30th 2009 | NEW YORK
From The Economist print edition

Should prisoners pay for being in prison?

PAY-IF-YOU-GO will be the new model for the criminal justice system if Jim Tedisco, a New York state assemblyman, gets his way. Mr Tedisco, a Republican who wants to "protect law-abiding citizens' tax dollars", has introduced a bill that would require rich inmates to pay for their involuntary stay in New York's prisons. The state spends more than $25,000 per inmate each year, more than $1 billion in total.

The bill has been dubbed the "Madoff bill", after the financier-turned-swindler who was sentenced in June to 150 years in jail. Why should taxpayers have to pay for Mr Madoff's prison-sentence, asks Mr Tedisco, when he has already cost people so much? The bill would require people with incomes of $40,000 or more to pay for part or all of their incarceration costs, depending on the size of their assets.

In theory, the bill sounds like justice delivered to Mr Madoff and other crooks. But ironically the law, if it passes, would not apply to the man who inspired it: Mr Madoff is in a federal prison, not a state or local one. The millionaires residing in prisons are, in fact, few and far between. According to the ACLU's National Prison Project, 80% of convicted felons have incomes below the poverty line.

A similar bill that requires inmates to pay for their incarceration was introduced in New Jersey this year; so was another one in Georgia, which was rejected. Mr Tedisco is urging New York's two senators to promote a bill in Washington, dc, in the hope of taking his movement national.

Some cash-strapped states have reduced the number of meals they serve to prisoners from three to two a day. So the idea of making crooks, especially white-collar ones, pay their way could take off. But others say it would be a mistake. Jail-birds often receive high fines, and adding to their debt might just encourage more crime. According to Sara Totonchi of the Southern Centre for Human Rights, an organisation that fought the Georgia bill, it could also burden convicts' families by making them financially responsible for their relative's jail-time. And that might breed yet more trouble.

Optimism in Mobile, Alabama

Let's have a party

Jul 30th 2009 | MOBILE
From The Economist print edition

A city that looks beyond the recession

IN JUNE a delegation of officials from Alabama packed their bags for the Paris Air Show. Along with officials from Mississippi and Florida they held a reception in the Eiffel Tower and enjoyed a cruise on the Seine. They appeared to be having a very good time, reported someone from Washington state, which is nervously eyeing Alabama's growing aerospace industry.

How, in these bad times, can Alabama or Mobile, its most charming city, be so jolly? In June the state's unemployment rate hit 10.1%, more than double what it was a year ago. And things will get worse before they get better: a new survey from the University of Alabama says that business leaders expect the state's economy to go on shrinking in the third quarter.

Nevertheless, people in Alabama, particularly in the south-west corner that includes Mobile, are refusing to be daunted. And their confidence is not misplaced. In recent years both city and state have been on a blitz of economic development. Most Alabamans trace the change back to 1993, when the state managed to land a Mercedes plant. This was a $300m investment that gave Alabama a big credibility boost. Honda and Hyundai plants followed and the state now has over 300 car-related companies. In 2006 Alabama won a Golden Shovel award from *Area Development* magazine, and this June it got a silver.

Mobile has had its own successes. Austal, an Australian shipbuilder, came to the city in 1999 and has been expanding. The port recently opened a new container terminal. ThyssenKrupp is building a large steel plant that will bring 2,700 jobs to the region next year. Boeing, Alabama's aerospace giant, is based in Huntsville but is spreading to the south of the state.

At the same time the city is smartening up. Ten years ago, says Win Hallett, the head of its Chamber of Commerce, the centre of Mobile was so ragged that he worried about visitors being frightened away by the hotels. In 2001 the schools superintendent gave out a dire warning: unless voters approved a property tax rise, he would have to cut the football programmes. The rise went ahead.

All this has given Mobilians their sunny outlook, despite the current economic woe. Last year Moody's Economy.com ranked Mobile County first among America's 363 metropolitan areas for projected economic growth between 2007 and 2012. In June *Forbes* included Mobile (and Huntsville) in its list of the ten cities best placed for recovery.

Mobile and Havana became sister cities in 1993 and, so far as they can, have kept up their ties ever since. There is a long relationship between southern Alabama and Cuba which, several hundred years ago, were trawled by the same cast of French and Spanish explorers. In the 19th century Mobilian doctors helped their Cuban peers fight yellow fever by destroying mosquitoes and a Cuban student who studied in Mobile returned home with a baseball and bat. City leaders are looking to benefit should there now at last be a change in America's policy towards Cuba.

Shopping

Keeping it local

Jul 30th 2009 | AUSTIN
From The Economist print edition

A rising vogue for shopping near home

IN 2002 the city of Austin planned to extend about $2m in incentives to a developer who wanted to build a new Borders bookstore on a prominent downtown corner. This was an unpleasant prospect for the owners of two local independent businesses, BookPeople and Waterloo Records. If the deal had gone through they would have faced a big competitor located directly across the street. Steve Bercu, the owner of BookPeople, says that he always assumed that local businesses were better for Austin for sound economic reasons. But in the circumstances, he wanted to test the proposition.

So BookPeople and Waterloo called in Civic Economics, a consultancy. They went through the books and found that for every $100 spent at the two locals, $45 stayed in Austin in wages to local staff, payments to other local merchants, and so on. When that sum went to a typical Borders store, only $13 went back into circulation locally.

Although the study was part-funded by BookPeople and Waterloo it gave a boost to the growing "buy local" movement in America. For years business and community leaders have been full of reasons for people to do their shopping close to home. They say that local and independent businesses have more individual character, and that they are owned by your friends and neighbours. Some stores, particularly grocers, point out that it takes much less carbon to haul a truck from a few towns over than from halfway across the country.

At the moment, the economic argument has special traction. Dan Houston, a partner at Civic Economics, says that in recent studies he has found that locally-owned businesses put about twice as much money back into the community as the chains do, not three times, as the Austin study found. But that is still enough of a "local multiplier" to catch people's attention. Stacy Mitchell of the Institute for Local Self-Reliance in Portland, Maine, reckons that some 30,000 local independents have joined about 130 independent business alliances around the nation.

Big companies are taking note that customers are rooting for the home team. Ms Mitchell points to a telling development in Seattle, Washington, where Starbucks got its start. On July 24th the company opened a new coffee shop there. The newcomer is not called a Starbucks; it is called "15th Ave. Coffee & Tea". It promises "a deep connection to the local community," and its seats are recycled from a local theatre.

There is an insular element to the trend. "Is it pure local protectionism? Sure, to some extent it is," says Mr Houston. But the advocates are not zealots. One national campaign is asking people to shift a mere 10% of their spending to local outfits.

The Borders project in Austin eventually fell through, and the proposed site is now occupied by the flagship of Whole Foods Market. The chain was founded in Austin and is local in a sense, although it is now publicly traded. Throughout the shop, produce advertises its credentials: local, organic, fairly traded, made in-house, vegan, and so on. This week its customers faced an ethical dilemma: is it better to buy the organic watermelon from California, or the conventionally-grown kind from Lexington, Texas?

California's Chinese-Americans

From nightmare to dream

Jul 30th 2009 | LOS ANGELES
From The Economist print edition

An official apology for the past marks a story of success

Getty Images

Welcome only as labour

HAUNTING Chinese poems speaking of pain are still visible on the faded walls of the old detention centre on Angel Island in San Francisco Bay. The island, today a state park, used to be the West Coast twin of Ellis Island in the east, and is the place where America showed a very different face to yellow newcomers than to white ones. Paul Fong's grandfather was detained there in 1939.

Today Mr Fong is a state assemblyman representing Silicon Valley, a place teeming with successful Chinese-Americans such as the co-founders of YouTube and Yahoo!. The Chinese in California are now arguably its most successful ethnic group, says Mr Fong. All the more reason for California to acknowledge what they overcame. This month, its legislature passed a resolution, co-sponsored by Mr Fong, apologising for a long history of discrimination.

In 1852, during the Gold Rush, California levied a punitive "foreign miners' tax" aimed at the Chinese diggers; whites paid nothing. In the following years, tens of thousands of Chinese blasted tunnels through the Sierra Nevada, with great loss of life, to build the western arm of the transcontinental railway. America said thank you by passing the Chinese Exclusion Act of 1882.

And so it went for much of the next century. Chinese coolies built California's tracks, levees and dams without the right to vote or testify in court, to marry whom they chose or to own property. The Chinese Exclusion Act was repealed only in 1943. California's constitution was only scrubbed of anti-Chinese discrimination in 1952.

The less formal forms of discrimination lasted a few decades more, recalls John Chen, the boss of a technology company and chairman of the Committee of 100, a group of eminent Chinese-Americans such as the architect I.M. Pei and the cellist Yo-Yo Ma. But today the Chinese are prominent on the campuses of Stanford and Berkeley, in engineering labs and orchestras, if not yet in corporate board rooms and politics.

If Chinese-Americans as a group have a worry at all, says Mr Chen, it is that their success might create a backlash—there are, for instance, plans at some university campuses to tighten admissions policies for Asians. But viewed as a whole, the story of the Chinese in California should be inspiring to all.

Canada's stalled economy

The humbling of Detroit North

Jul 30th 2009 | WINDSOR, ONTARIO
From The Economist print edition

The decline of America's car industry has hurt the Canadian economy too. Revival depends on making it easier to cross the border—or on seeking markets elsewhere

Illustration by David Simonds

FOR almost a century the fate and fortune of Windsor, Ontario, have been intertwined with those of Detroit, Michigan. General Motors (GM), Ford and Chrysler made cars on both sides of the Detroit River, sending parts and vehicles back and forth at will. Windsorites worked in the car plants, loyally bought the cars, followed American sports teams, and thought nothing of driving over the Ambassador Bridge or popping through the Detroit-Windsor tunnel for a night on the town.

So the collapse into bankruptcy of GM and Chrysler has brought Windsor down along with Detroit. A blue-collar city of 273,000 people, Windsor now has the highest jobless rate in Canada (14.4%) and faces an uncertain future. Its decline is visible on Ouellette Avenue, the main commercial artery. On some blocks, more shops have shut down than are still open. The brightest sign on the street announces the grand opening of Dollarama, a deep discount store. On the riverside promenade the headquarters of Chrysler Canada, opened with much hoopla in 2002, stands partly empty, a "For Rent" sign on the plate-glass window of its showroom. Truck traffic between Windsor and Detroit—the busiest crossing-point on the Canadian border—fell by a third in the first six months of this year compared with the same period in 2008.

Windsor's woes are echoed across southern Ontario, the heartland of industrial Canada, which depends on exporting to the United States. Tighter security at the border after the terrorist attacks of September 2001 and a stronger Canadian dollar constrained the region's economy even before the American economy plunged into recession in late 2007, with Detroit leading the decline.

Between them, Canada's federal government and Ontario's provincial administration contributed C$14.5 billion ($13.4 billion) to the bail-outs of GM and Chrysler. That was enough to deter them from pulling out of the country. But they will cut a slimmer figure. Output and employment in Canada's car industry

will end up at least a third below the 1999 peak of 3m vehicles and 160,000 workers at assembly plants and parts-makers, says Dennis DesRosiers, an industry analyst. It helps that Toyota and Honda, with factories in Ontario, are keeping most of their workers.

Ontario's problems go wider than cars. Recession has curbed demand for its minerals and forest products. Nortel, a telecoms firm that was once Canada's leading high-tech company, recently entered bankruptcy. Bits of it are being sold off piecemeal. Two-thirds of the 370,000 jobs lost in Canada between October 2008 and June 2009 were in Ontario, most of them in manufacturing.

Ontario's economy is still the biggest in Canada. But it is no longer the richest. Indeed Ontario is now classified as a have-not province, making it eligible for handouts from a federal fund to equalise public spending across the country. It has even been granted its own federally funded economic development agency.

Some pundits reckon that rather than bailing out industrial dinosaurs government should be encouraging new technologies. Supporters of Dalton McGuinty, the province's premier, say that he had no choice but to help to bail out the car industry because of its size. (He also offered a subsidy of C$10,000 to each purchaser of an electric car.) Critics contrast this largesse with the government's failure to help Nortel. Stephen Harper, Canada's Conservative prime minister, faces nationalist pressure to veto a bid of $1.1 billion from Sweden's Ericsson for its wireless technology division and find a Canadian buyer.

Even in car-mad Windsor people are starting to realise that change is inevitable. Eddie Francis, the mayor, says he hopes to make the municipal airport a processing centre for perishable cargo. He says that some of the city's car-parts makers have started supplying oil companies and Quebec's aerospace industry.

But diversification is not easy. Caesars Windsor, a massive casino, convention centre and hotel aimed at the 17m Americans who live within a three-hour drive, is suffering along with the car industry. Its workforce has shrunk from a peak of 5,400 before 2001 to 3,800 today. "It's not true that casinos are recession-proof," says Keith Andrews, the casino's spokesman. He is sitting in the hotel's 10,000 square-foot (930 square-metre) lobby, where statues of Roman gods and goddesses outnumber guests.

Canada's economy, like that of the United States, shows signs of recovery. Though weakened, the car industry will survive. The biggest headache for places like Windsor may be the thickening border. Since June 1st those returning to the United States from Canada have been required to show a passport (or another approved identity document), where a driving licence was always sufficient. Janet Napolitano, the secretary for homeland security, talks of treating America's northern border more like its southern one with Mexico (where the building of a fence on long stretches continues).

Security measures are not the only impediment to travel between Detroit and Windsor. The privately owned Ambassador Bridge and the public road and rail tunnels that link the two cities are old and narrow. Plans to build a new bridge, or add a span to the existing one, have bogged down in lawsuits. The owner of the Ambassador Bridge wants to protect his near-monopoly.

Like it or not, Canada is uncomfortably dependent on the United States as a market, with 76% of its exports going to its southern neighbour. Mr Harper's government has tried to open new markets. It is now negotiating a free-trade agreement with the European Union, for example. But places like Windsor, just a short stretch of water from the flickering beacon that is Detroit, can only hope that the American economy is quickly restored to health.

Post-coup Honduras

Time on whose side?

Jul 30th 2009 | TEGUCIGALPA
From The Economist print edition

Ratcheting up the pressure on Roberto Micheletti's de facto government

AP

Zelaya, and his hat, wait at the border

AS POPULAR insurrections go, it is a modest affair. Manuel Zelaya, who was ousted as Honduras's president a month ago, called on his supporters to join him in a makeshift camp on Nicaragua's border with his country in an attempt to put pressure on its de facto rulers. But only a few hundred defied an all-day curfew in the area and evaded army patrols to make it to the muddy border post. Having taken a symbolic step into Honduran territory on July 24th, Mr Zelaya retired to the nearest comfortable hotel on the other side.

These stunts have not discernibly loosened the grip on power of the de facto government headed by Roberto Micheletti. He was installed by the Congress after the army arrested and deported Mr Zelaya, whom the Supreme Court ruled had violated the constitution by trying to organise a referendum on constitutional reform with the apparent intention of seeking a second term. But the outside world saw Mr Zelaya's removal as a military coup. No government has recognised Mr Micheletti.

In Tegucigalpa, the capital, life goes on. Shops are open, traffic is heavy, and the curfew now starts later, at 1.00am. Soldiers guard government buildings but no longer patrol the streets. In opinion polls 60%-70% of those who express an opinion say they do not object to Mr Zelaya's removal.

Armed with that support, Mr Micheletti stalled a mediation plan proposed by Óscar Arias, the president of Costa Rica, with the support of the Organisation of American States (OAS). This would return Mr Zelaya to office with limited powers: he would have to abandon constitutional reform, establish a unity government, bring forward the November 29th presidential election and hand control of the army to the electoral tribunal. "It's a question of sovereignty," says Carlos López Contreras, Mr Micheletti's foreign minister. "We can't allow [outsiders] to impose Zelaya on Honduras like the governor of a colony."

The plan seemed to be to hang on until the election. Both the main presidential candidates won primaries before the coup took place. Both recognise Mr Micheletti. But there were signs that the de facto government is starting to buckle. The army said it would not interfere if the Arias plan was approved. On July 29th Mr Micheletti contacted Mr Arias to ask for further talks. He is said to want help to convince his own supporters to accept Mr Zelaya's return.

Defiance has cost Honduras the suspension of foreign aid equal to 6% of GDP and expulsion from the OAS. Barack Obama's American administration has shown little enthusiasm for imposing sweeping sanctions to support Mr Zelaya, an ally of Venezuela's anti-American president, Hugo Chávez. But on July 28th the United States said it was rescinding diplomatic visas held by four members of Mr Micheletti's government. José Miguel Insulza, the OAS secretary-general, has insisted that the region's governments

would not recognise the election if it is staged under an illegitimate regime.

Mr Zelaya may have one or two other cards. He claims to have the support of middle-ranking army officers. His supporters say he is forming a "militia" to conduct civil disobedience in Honduras. The political conflict has aggravated the impact of world recession on an already poverty-stricken economy. The strikes and roadblocks mounted by Mr Zelaya's supporters will trim two percentage points from GDP this year, says Manuel Bautista, an economist in Tegucigalpa. He reckons that retail sales in the two largest cities have dropped by 30% since the coup. The government's coffers are empty, because of the aid suspensions and Mr Zelaya's profligacy.

If Mr Micheletti's initiative comes to nought, the only means of forcing the de facto government to yield—besides the military invasion threatened by Mr Chávez—would be trade sanctions. Honduras's small, open economy is heavily dependent on trade with the United States and Central America. But implementing a trade embargo would hurt its neighbours too. It is in everyone's interest for diplomacy to succeed.

Affirmative action in Colombia

Debating quotas

Jul 30th 2009 | BOGOTÁ
From The Economist print edition

Black Colombians suffer "structural discrimination"

Reuters

ASK Colombians about racism in their country and many will say that the country's *mestizos*, blacks, *mulatos* and whites live in harmony. Some Afro-Colombians, such as Edna Martínez, a sociologist, tell a different story. She remembers seeing, as a child growing up in Bogotá's poor neighbourhoods, a sign in an apartment window that read, "For rent, but not to blacks". More recently when out with friends she was turned away from three different night clubs that either claimed to be closed for private parties or threatened exorbitant cover charges. A lawsuit last year won them a public apology. "But it didn't really change anything," Ms Martínez says. Such experiences are why some black Colombians support a government plan to present an affirmative-action bill to Congress later this year.

Colombia's 1991 constitution recognised the country's multiethnic character, and provided for two additional seats in Congress for Afro-Colombians and a similar quota for Amerindians. Two years later Afro-Colombian communities on the Pacific coast were granted collective titles to land occupied by their ancestors when slavery was abolished in 1851.

Despite such steps, a committee to study racial inequality set up by the government and headed by Francisco Santos, the vice-president, concluded in May that black Colombians face "structural discrimination". It reported that they were more likely to be poor and that their infant mortality rate was half as high again as that of the rest of the population. In Chocó province, where four out of five people are black, life expectancy at birth is 58.3 years, compared with the national average of 70.3. "We recognise now that there is a problem," said Mr Santos.

The committee proposed quotas for blacks in universities, government agencies and the armed forces, and incentives for companies to recruit Afro-Colombians as middle managers and for political parties to field black candidates. The role of Afro-Colombians, today little more than a footnote in history books, would be highlighted in school texts.

"The myth that there is no racism here is the maximum expression of discrimination," says César Rodríguez, who heads a research centre on socio-legal studies at Bogotá's University of the Andes. Afro-Colombian leaders have called for affirmative action for years. Some worry that the proposals will not be implemented, and that the committee was aimed mainly at placating the Congressional Black Caucus in the United States, in the hope of gaining its backing for a free-trade agreement between Colombia and the United States. But other black leaders fear that quotas may ignite racial conflict. Daniel Mera of Fundación Color, an NGO, says that what is needed instead of quotas are better educational and social policies so that black Colombians can compete on equal terms.

The first problem will be deciding who is black. In the 2005 census 10.6% of the population thus defined themselves, but some demographers say the real figure could be as high as 26% (which would mean that Colombia has the third-biggest black population in the Americas, after Brazil and the United States). That is because many *mulatos* do not see themselves as black. This may be either because they do not feel discriminated against—or as a means to avoid discrimination.

Chile's stricken salmon farms

Dying assets

Jul 30th 2009 | SANTIAGO
From The Economist print edition

A bankrupt industry faces reform

THIS time two years ago some 300m Atlantic salmon were being fattened in farms off the coast of southern Chile. Now its sheltered bays contain just a tenth of that number. Many fish have died of infectious salmon anaemia (ISA), a virus, whereas others have been prematurely harvested for fear they would catch it too. Coho salmon and trout, which Chile also produces, are not susceptible to ISA. Even so, output of the country's fish farms this year is expected to be down by at least 40%. The industry faces a long road back to health.

This blow comes after 15 years of meteoric growth that saw exports rise more than tenfold to $2.3 billion in 2007, turned Chile into the world's second-biggest salmon producer after Norway, and brought prosperity to a far-flung area with few other jobs.

Salmon farms in Norway, Scotland and Canada have all suffered ISA too. Even so, Chile seems to have been unprepared for the virus when it turned up, apparently in imported salmon eggs. The farmers seem to have been blinded by booming profits. The National Fisheries Service, the industry's regulator which is more used to policing catch quotas at sea, lacked both a plan and the powers to deal with ISA. The resulting disaster has bankrupted the industry, which had piled up $1.8 billion in bank debts by last December.

With over half of salmon farms now empty of fish, the industry has the chance to restock and start again, says César Barros of SalmonChile, the industry association. He reckons output will be back to its 2007 level within four years. It could take longer. Congress is, slowly, debating a bill to regulate the industry more tightly. The fisheries service will have to be strengthened. And the farms need working capital to restock. The banks may not oblige, although they have renegotiated much of the debt.

The industry has also come up with a voluntary plan to reduce the use of antibiotics to control disease—a practice which has harmed the image of Chilean salmon in the United States. Hitherto, lower production costs allowed Chilean salmon to compete in the United States against less distant rivals. The reforms might erode that advantage—but perhaps not if they work: salmon farmers hope that fewer dead fish will compensate for the cost of cleaning up their act.

Clarification: Bolivia and Venezuela

Jul 30th 2009
From The Economist print edition

In our recent story on Bolivia ("The permanent campaign", July 18th), we stated that "Venezuelan troops helped quell a rebellion centred on the airport at Santa Cruz in the east in 2007". Both the Venezuelan and Bolivian governments deny this (see Letters), and Venezuela's government has publicly asked us to retract this assertion. We based our statement on television footage aired at the time which shows a Venezuelan air force plane and uniformed Venezuelan personnel at Santa Cruz airport shortly after it had been seized by the Bolivian government from the local authorities. No official explanation has been given for their presence. However, we are happy to clarify that this footage does not prove Venezuelan troops played an active role in quelling the rebellion. We have placed the television footage on our website.

Japan's election

The opposition peers ahead

Jul 30th 2009 | TOKYO
From The Economist print edition

The DPJ lays out its credentials for governing

Reuters

WITH an election due on August 30th, an animated cartoon has proved a surprise internet hit in Japan. At a candlelit dinner, a smooth-talking suitor with wavy locks like the opposition leader's leans over and whispers to his companion, "I can make you happier, why not switch to me," promising her a worry-free life blessed by free child-care and a generous retirement. How will you pay for all this, she wonders? "Don't worry," he purrs. "I'll sort out the details once we're married."

This is Japan's first taste of attack advertising. The cartoon's sponsor, the ruling Liberal Democratic Party (LDP), may be a shambles, empty of ideas and brought low by in-fighting, but its ruthless political instincts have not deserted it after half a century of nearly unbroken rule. It accuses the left-leaning Democratic Party of Japan (DPJ) of being both callow and extreme, fit neither to oversee Japan's security alliance with the United States, nor to protect the nation's rocky finances.

The charge of inexperience may not stick. Given the sleaze and incompetence of the mightily experienced LDP, which has produced four prime ministers in as many years, freshness has a certain appeal. The second charge, of extremism, though, may yet damage the DPJ. So on foreign policy, the opposition is tacking to the centre. In the past, its leader, Yukio Hatoyama, has questioned parts of the security alliance with America and the role of Japanese forces abroad. Two years ago, having won control of the upper house of the Diet (parliament), the DPJ claimed the scalp of a prime minister, Shinzo Abe, by attacking the Japanese navy's refuelling mission in the Indian Ocean, there to support anti-terror operations in Afghanistan. The mission, it said, breached the country's pacifist constitution. Now "continuity" is Mr Hatoyama's watchword. To recall the mission "would be a very reckless idea." The alliance, he now says, must not be rocked.

Yet the election will be won or lost on domestic matters. In its election manifesto, issued on July 27th, the party promises to address Japan's deep-seated economic insecurities. It will introduce a child allowance, cut road tolls and taxes on small businesses, raise unemployment benefits, support farmers' incomes and revamp a pension system that cannot keep up with an ageing population. More than anything, the pensions mess brought the LDP low (it lost 50m pensions records).

The opposition's proposals amount to 3.5% of GDP and paying for them seems to depend on more than a sprinkle of fairy gold. More than ¥9 trillion ($95 billion), the party says, will be found in savings from public works and other wasteful spending. The party rules out raising Japan's 5% consumption tax for at least four years, though that is key to turning round the dire public finances. Gross national debt is 180% of GDP and rising, as LDP stimulus packages—justified by the global slump—kick in.

Whether the DPJ's sums add up at this stage, however, matters less than its ability to carry out its main campaign promise: wholesale "administrative reform". This bland phrase amounts to a revolution. The party promises "rule by politicians not by bureaucrats", something that did not happen during the LDP's decades in office. Unlike in other democracies, power in Japan has rarely resided in the government of the day. Rather, influential bureaucrats have worked with "tribes" of politicians to protect the interests of road builders, construction companies, farmers and other lobbies. In addition, ministries control special funds of their own, so the cabinet's hold over the national purse strings is weak. Policymaking bodies within the LDP itself have further undermined the authority of the prime minister. In the latest general election, in 2005, the then prime minister, Junichiro Koizumi, challenged the system by appealing directly to voters. He won by a landslide. But even before he resigned in 2006, the system was reasserting itself.

The DPJ's plans are much more radical than Mr Koizumi's. The cabinet will be responsible for the planning and execution of policy. Bureaucrats will be made accountable to their minister, and discipline enforced by putting more politicians into ministries. The budget-making process will be centralised, and items scrutinised line by line. The party's secretary-general, Katsuya Okada, says severing all connections with the bureaucratic habits of the past will be a prerequisite for carrying out the DPJ's other election promises.

That is probably correct but the question is whether so bold a reform is believable. The manifesto is central to the DPJ's credibility. That, in itself, is a first for Japan. The manifesto proposes a four-year programme for sorting out state pensions and rationalising the budget. Akira Nagatsuma, the DPJ's pensions supremo, says a copy of the programme will be posted in every government office, "a reminder to bureaucrats that this is the government's contract with the people." If the party pushes through its programmes, party members say, then it will ask voters in four years' time to approve the rise in the consumption tax that will presumably be needed. Should a tax increase be necessary before then, Mr Okada says, the prime minister should resign and call a fresh election.

Manifesto destiny

If the DPJ wins (and it is ahead in opinion polls, see chart), it can expect dogged resistance from the LDP and its bureaucratic allies. Even if it can defeat such campaigns—and it should get some help from modernising bureaucrats, who say they look forward to working under its proposed changes—two big uncertainties remain. One is that in addressing economic insecurities, the party appears concerned with redistribution at the expense of boosting long-run potential. Beyond a nod towards things like green technologies and nursing homes, the party appears to give little thought to increasing growth, allocating resources better or dealing with stubborn deflation.

The second uncertainty has to do with the role of the DPJ figure who towers over all his colleagues, Mr Hatoyama included: Ichiro Ozawa, once an LDP bigwig, then DPJ leader who was forced by a funding scandal to step down as party leader in the spring. Mr Ozawa is a bundle of contradictions. For nearly two decades he has worked to bring about a political upheaval in which LDP-led rule is replaced by a competitive two-party system. He may succeed at last. At the same time, Mr Ozawa, an electoral strategist of genius, learnt from his years in the LDP to play politics behind the scenes. In the Diet he comes across as dour. In private his quicksilver manner can charm colleagues or just as quickly destroy them. By temperament, Mr Ozawa would rather not sit in the cabinet, accountable to the prime minister. But that informal style of politics is just what the DPJ promises to break with. Should the DPJ win on August 30th, what Mr Hatoyama does with Mr Ozawa will be the first test of whether the party can bring Japan's politics out of the shadows.

Asia's economies

From slump to jump

Jul 30th 2009 | HONG KONG
From The Economist print edition

The gap between growth in emerging Asia and the G7 has never been wider

EARLY this year Asia's economies were falling shockingly fast; now they are rebounding even more strongly than expected. Year-on-year growth rates conceal this bounce; to spot the turning-point, look at quarterly changes. Comparing the second quarter with the first at an annualised rate, South Korea's GDP grew by almost 10% (though it is still down 2.5% on a year earlier); Singapore's soared by 20% (3.7% down on the year). China does not publish quarterly figures, but economists think its GDP jumped by an annualised 15-17%.

Other economies in the region have yet to publish their GDP numbers, but they are also likely to show a rebound. During the second quarter, Taiwan's industrial production jumped by an annualised 89%. Even Japan may have enjoyed robust GDP growth; its industrial production rose by an annualised 38%. In contrast, America and Europe probably saw their economies contract during the quarter.

Quarterly growth rates are likely to moderate in the second half of this year. Singapore's bounce, for example, was partly due to a big increase in pharmaceuticals production, which is notoriously volatile. Nevertheless, Asia's recovery is on track. Peter Redward, an economist at Barclays Capital, expects average GDP growth in emerging Asia of almost 5% in 2009 as a whole. Meanwhile, the G7 economies are likely to contract by perhaps 3.5% this year. That growth gap of 8.5 percentage points would be the biggest on record.

Six months ago the Asian economies were among the hardest hit in the world, as exports to the rich world plunged. How can they be bouncing back when demand in America and Europe remains feeble? One reason is that the plunge in output in late 2008 and early this year was exacerbated by massive destocking (companies were living off their existing supplies). With stocks now lean, orders are picking up and factories have started to hum again. Even more important, domestic demand has rebounded, thanks to the biggest fiscal stimulus of any region of the world. South Korea's real consumer spending rose at an annualised rate of 14% in the second quarter, spurred by a tax cut on car purchases and support for low-income families. Its exports also surged, by an annualised 53%, partly thanks to strong Chinese demand.

Sceptics argue that China alone cannot ignite economic recovery across the region because a large portion of Asia's exports to China are just intermediate goods, which are processed into exports to developed economies. The Asian Development Bank calculates that 60% of the region's exports eventually end up in the rich world. However, this ignores the huge boost that China's rebound is giving to business and consumer confidence across the region.

If the West continues to sputter, what happens when Asia's fiscal stimulus and restocking fade? A recent report by Frederic Neumann and Robert Prior-Wandesforde at HSBC argues that Asia's recovery will be sustained well into next year, thanks to loose monetary policies. Unlike in America and Europe, where crippled banking systems and high debts blunt the impact of low interest rates, Asia, especially China, is awash with liquidity, which will support domestic spending (see article).

Perhaps the main risk now facing emerging Asia is not feeble demand in the West but inflation or asset-price bubbles at home. The Reserve Bank of India has raised its inflation forecast for this year to 5%, well above its target of 3%. China's banking regulator has ordered banks to stick to the rules on mortgages and make sure lending goes into the real economy, not shares. If America's Fed had done this and worried a bit more about bubbles, the world might not be in such a mess.

China's labour laws

Arbitration needed

Jul 30th 2009 | BEIJING
From The Economist print edition

What lies behind the gruesome death of a manager at Tonghua Iron and Steel?

WORKERS' opposition to privatisation and job cuts is widespread but rarely takes so brutal a form as it did on July 24th in northeastern Jilin province, when steel workers chased down and killed an executive who had reportedly come to tell them that an imminent privatisation of their factory would bring massive job cuts. Hong Kong-based human-rights monitors reported that 30,000 workers were involved, though Chinese officials insist the number was lower. By all accounts, the ugly scene at the Tonghua Iron and Steel Plant ended in the bloody beating and death of Chen Guojun, general manager of the private Jianlong Group which already owned a minority stake in the plant.

The incident highlights not only China's labour discontent but the country's difficulty in dealing with it. Last year, China introduced a series of labour laws that improved mediation and set up an arbitration process to give workers better formal recourse for their grievances, both individual and collective. Workers have indeed been using the process in greater numbers (see chart). But only a small share of disputes are taken up, whereas discontents are multiplying. Whether in factories, mines or construction sites, workplace conditions in China are often atrocious, and workers' safety an afterthought. Nominal legal provisions calling for minimum wages and guaranteed rest days are routinely ignored. One of commonest complaints is the failure to pay wages. Workers go months without being paid, leading to frequent sit-ins or demonstrations.

None of these actions is organised by unions. In name, the All-China Federation of Trade Unions (ACFTU) is a vast union bureaucracy running from the national level to small enterprises. In practice it is controlled by the Communist Party at the national level and, in companies, is mostly a tool of the management. According to Chris Xiaoyun Lin, a lawyer specialising in Chinese labour, unions may find ways to play a greater role in future, such as by drafting labour laws and representing workers in collective bargaining. But they are unlikely to gain independence from the party—or anything like the influence of unions in Japan or South Korea.

When Chinese labour disputes get unruly, local governments often respond by trying to placate the workers and maintain stability, according to Geoffrey Crothall of the Hong Kong-based *China Labour Bulletin*. "They recognise that workers have legitimate grievances and are not rabble-rousers out to overthrow the government." On the day of the Tonghua incident, the provincial government ordered Jianlong to abandon its plan to buy out the steel plant. Placating protesting workers may help calm a tense situation. But in the absence of genuine unions or better enforcement of the laws, it may also serve to encourage more protests.

Gurkhas in Nepal

Old soldiers fade away

Jul 30th 2009 | KATHMANDU AND DHARAN
From The Economist print edition

Nepalis do not see the Gurkhas in quite the same light as the British do

AFP

Lahures love Lumley

THIS week Joanna Lumley, a British actress, received the most extravagant of welcomes in Nepal. She was mobbed at the airport, met the prime minister and president and was lauded by the speaker of parliament as a "daughter of Nepal". Her reception was a thank you for heading a campaign that persuaded the British government to change its mind and allow United Kingdom residency to Nepali Gurkhas who had served in the British army but had retired before 1997. The moral case was attractive: if someone is willing to die for a country he should be allowed to live in it. The rhetoric that accompanied the campaign was striking, too: it celebrated the martial races of the Himalayan foothills, who are plucky and loyal.

But given that Ms Lumley's success means that thousands of relatively rich Nepalis will leave a badly governed country, the reception she received might seem strange; indeed, it puzzled some Nepalis. But it is, perhaps, no odder than the position of the Gurkhas in their own country.

The Nepali name for a Gurkha is "lahure", after the city of Lahore where Gurkhas regiments once served. The name is now applied to the roughly 10% of Nepalis who work abroad. In 2008 their remittances amounted to 17% of national income, one of the world's higher rates. Almost every poor family has one of these new "lahures" and every middle-class family has members who went to study abroad and may never return. To this exodus may now be added up to 35,000 "pre-97" Gurkhas and their dependents now living in Nepal.

That is bad news for the economy and especially for towns such as Dharan which have large ex-Gurkha populations. British army pay and pensions have given Dharan a relatively prosperous air. The manager of a bank on the high street and many of the Gurkhas who turned up to greet the victorious British campaigner said the local economy is bound to suffer.

Few Nepalis feel strongly about Gurkhas' complaints of unequal treatment by the British. The soldiers come almost exclusively from a few ethnic groups—and only 230 were recruited last year. This makes them merely one subculture in a country of 100-odd castes and clans, some of whom are at each others' throats, where the government is unstable. The common attitude is one of slight mockery, expressed in condescending jokes about the Gurkhas' supposed naivety and unruly wives and children.

"They are not connected to all Nepalis, but they are part of Nepali identity and whenever a Nepali does well abroad we are always proud," says Gunaraj Luitel, a writer. The old Gurkha is a familiar figure in the villages where many Nepalis grew up. They helped introduce foreign ideas when they returned from service abroad and perhaps assisted the spread of Nepali as a national language. Now, sadly, they have come to represent something new: the desire of Nepalis to live and work outside their country.

Kyrgyzstan's election

Tulips squashed

Jul 30th 2009
From The Economist print edition

The significance of the president's easy re-election

TO NOBODY'S surprise, Kyrgyzstan's incumbent president, Kurmanbek Bakiev, won re-election for another five-year term on July 23rd. Even the percentage of people of who voted for him—76.4—was standard for a former Soviet republic. Most post-Soviet authoritarian leaders have learned by now that rigging the vote to get more than 90% invites ridicule. The modern dictator arranges to receive 65-85% of votes—high enough to intimidate opponents, low enough to look democratic.

The surprise of this election, however, was how poorly it was organised. Election day was marred by ballot-stuffing, inaccuracies in voter lists and multiple voting. The previous presidential election held in 2005, almost four months after the so-called Tulip revolution, got a thumbs-up from the Organisation for Security and Co-operation in Europe (of which Kyrgyzstan, rather oddly, is a member). This time, the organisation called the vote "a disappointment". That is also how many Kyrgyz feel about Mr Bakiev. He won partly because the opposition was too divided to offer a decent alternative.

The Tulip revolution—during which the long-serving president, Askar Akaev, was literally chased out of his office by angry demonstrators—had been a time of hope. The election that followed was a new start for the 5.2m people of mountainous Kyrgyzstan, widely considered to be the Central Asian country with the best chance at democracy and most flourishing civil society. These hopes were soon dashed.

Once elected, Mr Bakiev ignored his promises to limit presidential powers and to hand more authority to parliament. But he complied with the local custom of taking care of kith and kin by making one brother head of the state security service and another ambassador to Germany. For many Kyrgyz, it seems as if the disliked Akaev clan was being replaced by the Bakiev one. Though salaries and pensions were boosted and government spending increased, corruption has become more endemic and lawlessness has increased. In April Sanjarbek Kadyraliev became the fourth parliamentarian to be assassinated since the revolution. Independent journalists are frequently targeted, including Almaz Tashiev, who died on July 12th after being beaten up by policemen.

But, quite unexpectedly, Mr Bakiev has proven to be skilled at playing off Russia and America. He seems to know just what his country is worth in the fight against international terrorism. Kyrgyzstan is the only country to host both a Russian and an American military base. Mr Bakiev was promised more than $2 billion in aid and loans by Russia in February, after which he declared the American base at Manas would be closed within six months.

Recently Mr Bakiev agreed to extend the lease of Manas, which provides support for personnel and cargo transiting in and out of Afghanistan as well as aerial refuelling, in exchange for more than tripling the annual rent to $60m, plus more than $100m in investment. Russia's response has been swift. The latest news is that the government in Moscow is negotiating to set up a second Russian military base in Kyrgyzstan. That would bring in more rent.

The money is needed. Kyrgyzstan is suffering from the global slump, which has reduced the remittances sent home by its migrant workers in Russia and neighbouring Kazakhstan. The country faces a possible challenge from jihadists who may have been responsible for several firefights around its porous southern border. Some Islamist fighters of Central Asian background are believed to have returned there after the surge of American troops in Afghanistan and Pakistan's offensive against the Taliban in tribal areas. However skilful Mr Bakiev's diplomacy may be, he still has his work cut out.

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ASIA

Initiation rituals in Indian universities

Curbing the ragging trade

Jul 30th 2009 | DELHI
From The Economist print edition

India cracks down on hazing and harassment

AFP

Not really student fun and games

ARSHEE KHOSLA, a pretty 19-year-old economics student, looks anxious as she approaches her Delhi University campus. More unsettling to her than first-day nerves is the line of khaki-clad police who stand guard at the gate. They are there to prevent "ragging", the bullying meted out to first-year undergraduates by older students in universities across India. Around the gates, alongside invitations to join myriad extra-curricular societies, posters declaim that "An Act of Ragging May Land You in Jail".

Initiation rites for new students occur in universities all over the world. Sometimes, they get out of hand. But in India, where ragging might involve forcing "fachchas", as freshers are known, to perform racy Bollywood dance routines before crowds, it has so often tended towards violent bullying that the government is trying to stamp it out altogether. In March an 18-year-old medical student, Aman Kachroo, was beaten to death by third-year students in the northern state of Himachal Pradesh during a ragging ceremony. According to the Coalition to Uproot Ragging from Education (CURE), an NGO, his was the twelfth death caused by ragging in the past year, a tally that includes suicides.

There are several reasons why student bullying should have become dangerous in India. Harsh Agarwal of CURE believes that Indian undergraduates mimic the kind of hazing rituals they see in Hollywood movies "but they don't really understand and get it wrong". Many educationalists believe that as more low-caste Indians attend university, ragging is used to subjugate them—although "just as often it is lower castes trying to hurt upper castes", says Mr Agarwal. Sex plays its part; ragging is often an excuse for older students to badger freshers. In June a college in Uttar Pradesh banned female students from wearing "vulgar western" clothing. Sexual harassment, known in India as "Eve teasing", seems to be on the rise as the media expose a conservative society to more permissive cultures.

India's state and central governments are trying to curb ragging. Tamil Nadu became the first state to pass an anti-ragging law in 1997; a handful have followed. In February the supreme court declared ragging a "human-rights abuse in essence" and ordered measures to stamp it out, including stopping funding to universities with especially poor records. Delhi University, like others, responded with closed-circuit television cameras, mobile anti-ragging squads and reams of posters. Miss Khosla hopes she will "get away with a song."

Banyan

Malaysia's chameleon

Jul 30th 2009
From The Economist print edition

The rise, fall and rise of Anwar Ibrahim, South-East Asia's most extraordinary politician

Illustration by M. Morgenstern

ONE evening in mid-July Anwar Ibrahim was deep in the rubber-tapping state of Kelantan in northern Malaysia, urging a crowd of rural folk to vote for a devout fishmonger. The candidate was from the conservative Islamic Party (PAS). A tiny by-election for the state assembly PAS already dominates is ordinarily small beer (or would be, if PAS allowed such a beverage, which it does not). But Mr Anwar needs PAS. For the paradox is that without the Islamists, the alliance he leads of Malay modernisers, Indians and secular Chinese has little chance of driving the ruling United Malays National Organisation (UMNO) from power. The coalition that UMNO dominates has ruled Malaysia since independence in 1957. Mr Anwar longs for UMNO's destruction. The feeling is mutual.

That morning, Mr Anwar had been in Perth where he had met Australia's foreign minister. What had he been doing with Stephen Smith? "Plotting," replies Mr Anwar, with a conspiratorial wink. Mr Anwar spends a lot of time abroad with national and religious leaders whose names he drops slightly too easily into an engaging conversational style. He moves like quicksilver from one intriguing subject to the next, but you get the uncanny sense that he is speaking to what interests you.

Mr Anwar thinks he will soon need international support. Two days after stumping in Kelantan, pre-trial hearings began in a case in which Mr Anwar stands accused of sodomising a political aide "against the order of nature". Mr Anwar vigorously denies the charges. He says he is the victim of a political stitch-up. International outrage might help him. Much is fishy about the case. Photographs of the former aide who brought the accusations show him with UMNO members, including people close to the current prime minister, Najib Razak. The charge has been changed from sexual assault to "consensual sex", yet his accuser has not been charged. (All homosexuality is illegal in Malaysia.)

Mr Anwar has been here before. In 1998 he was charged with corruption and homosexual acts. In custody, he was beaten up by the chief of police. He spent six years in jail, mostly in solitary confinement, until his conviction was overturned. Upon release, his political career seemed over.

It is easy to forget now but for many years Mr Anwar led a charmed life. He made his name as an Islamist student leader in the 1970s and was even jailed under the draconian Internal Security Act. Then he shocked his former colleagues by joining UMNO, where his rise was spectacular. By 1993 he was deputy prime minister and heir to Mahathir Mohamad, the country's long-serving leader. Malaysia seemed about

to fall into his lap. "Ah," says Mr Anwar, "the good old days."

But during the Asian financial crisis of 1997-98, Mr Anwar moved too soon against his mentor, who after 16 years in power was not ready to bow out. Mr Anwar railed against the UMNO cronyism from which he had benefited. Livid, Dr Mahathir threw him out of the cabinet and launched Mr Anwar's persecution. Mr Anwar's *reformasi* movement sputtered out with his jailing.

Yet the hopes which that movement represented surged again after the general election of March 2008, and especially after August 2008 when Mr Anwar won a seat in Penang. In the election the ruling coalition lost its precious two-thirds majority which gave it power to change the constitution. It has since lost five out of six by-elections to Mr Anwar's forces, which also control four of 13 states. In getting out its message, the opposition has been helped by an explosion of internet opinion that has undermined the influence of the UMNO-controlled mainstream media.

UMNO's back is against the wall. Even its own officials admit to its arrogance, with corruption bound into the fabric of its power. The New Economic Policy (NEP, introduced in 1971) instituted racial preferences for majority Malays, when ethnic Chinese and Indians owned much of business. But instead of helping the poor, the NEP has enriched rent-seekers around the ruling party, while dragging down economic growth. Resentment has spread from Chinese and Indians to poor or pious Malays.

This has made possible Mr Anwar's strange alliance. In calling for the end to the NEP, he says poor Chinese and Indians need help as much as Malays—but because there are more poor Malays than other races, they will still get the lion's share of government help. It is a possible way out from the baneful influence of race on Malaysian politics. But the real strength of this alliance is that Mr Anwar's charisma and political nous holds it together. Alas, that it is potential weakness, too.

Trials and tribulations

The challenges for Mr Anwar and his alliance will now multiply. For a start, Mr Najib, prime minister since April, has said the NEP must adapt, stealing some of his opponent's thunder.

Then there is the time-consuming trial. Mr Anwar says he will win whatever the verdict. If he is acquitted, the government which brought the case will be discredited. If found guilty, tens of thousands of supporters will take to the streets. Mr Anwar hints tantalisingly at new information in a murder case that has gripped the country partly because of its links to Mr Najib. This, he suggests, gives him ammunition to fight back.

Intriguing, but it is unlikely to be enough. If Mr Anwar does go to jail, the alliance may not survive the loss of its leader. If he calls out his supporters—for something of the martyr lurks in him—he may be blamed for the ensuing chaos. And if he appeals to international opinion, his local supporters may question that.

This points to a trap waiting to catch the silver-tongued Mr Anwar, who deftly tells different audiences—religious or secular—what they like to hear. The same blogosphere that helped his meteoric rise may one day pay more attention to his chameleon qualities. Malaysians would then come to ask more closely: who and what exactly does Anwar stand for?

Israel and Palestine

Not quite as gloomy as they look

Jul 30th 2009 | JERUSALEM AND RAMALLAH
From The Economist print edition

The contours of a peace deal are clear. But who has the courage to draw them?

Illustration by Peter Schrank

BACK in the autumn of last year, Ehud Olmert, then Israel's fading prime minister, and Mahmoud Abbas, the Palestinians' more durable president, were astonishingly close to a peace deal. Judging by an interview with Mr Olmert published in *Newsweek* in June, after he had given up his post, they appeared to have been only a whisker apart—though Mr Abbas has since called the gap "wide". But it is worth spelling out what Mr Olmert says he offered, in an account that other senior Palestinians have pretty much verified. For it starkly shows what both sides need to do to clinch the deal—and how feasible it is.

According to the report, Mr Olmert offered the Palestinians nearly 94% of the West Bank as the basis of their would-be state, plus land swaps of Israeli territory to make up the difference, amounting to nearly 6%, plus a safe-passage road-corridor to link Gaza with the West Bank.

Mr Olmert is said to have also offered to internationalise the sovereignty of the "holy basin" of Jerusalem—principally, the Western ("Wailing") Wall, which is sacred to Jews, and the al-Aqsa mosque (the Dome on the Rock) above it that is revered by Muslims. The city of Jerusalem, by implication, would be shared as a capital of both states, with the Palestinian one on the east side, the Israeli one on the west.

Finally, perhaps most controversially, Mr Olmert says he offered to let a small number of Palestinians return to the lands in Israel from which they or their forebears had fled after the Jewish state was founded in 1948. That did not, says Mr Olmert, amount to a "right of return". The number who would go back to Israel was "smaller than the number the Palestinians wanted". Although Mr Abbas put a different slant on the offer, they were groping towards what some diplomats say might be a mutually acceptable formula: an acknowledgment of the Palestinians' right of return that would largely be symbolic, rather than a passport for millions. Elsewhere, a figure of 30,000 returning Palestinians has been informally mooted.

If drawing borders is the simplest problem and the mechanisms for sharing Jerusalem the most complex,

the argument over the Palestinians' right of return may well be the thorniest of all, because if huge numbers of Palestinians returned, Israel would no longer be a predominantly Jewish state. A formula has been aired whereby the number could go up or down, year by year, in sync with Israel's population.

Binyamin Netanyahu, Israel's present prime minister, seems to want to be more rigid than Mr Olmert was, by insisting as a precondition for talks that the Palestinians drop their claim to a right of return and that they formally acknowledge Israel as a "Jewish state". But for the Palestinians this would pre-emptively destroy the hope even of a symbolic statement by Israel acknowledging the "catastrophe" (*nakba*, in Arabic), as they term it, that befell them when Israel was created. Moreover, the Palestinians fear that, if they gave in to Mr Netanyahu on this score, that might undermine the rights of Israel's Arab citizens, who make up a fifth of Israel's population.

Mr Abbas, who does not deny the nub of the account, felt unable to sign on, especially as Mr Olmert was already on his way out of government. Besides, on the question of the map, which was perhaps the most dramatic of the various near-breakthroughs, Mr Olmert would not, he says, actually let him have a copy.

Moreover, the entire negotiation that followed the meeting at Annapolis in late 2007, under the aegis of President George Bush, was "poisoned", in the words of the chief Palestinian negotiator, by Israel's refusal to stop building Jewish settlements in the West Bank. Recently it was reported that the number of Israeli settlers there (excluding the 190,000 Jews who now live in what used to be Arab East Jerusalem) had surpassed 300,000. The figure has doubled in a dozen years. The longer the Israelis continue to settle the West Bank, and to cut roads through it that can often be used by Israelis only, the harder it will be to create a workable Palestinian state on contiguous land rather than a series of cantons criss-crossed by Israeli roads connecting settlements. Moreover, Israel's security barrier already fences off more than 9% of the West Bank, according to a recent UN report. The longer the settlers have to dig in, the harder it will be to displace them under a final agreement.

Those toxic settlements

Hence Barack Obama's concentration on squeezing Mr Netanyahu into stopping the settlements' building and expansion, including what is known as "natural growth" to cater for burgeoning settler families. In the past few weeks the Israeli leader has been trying to wriggle off Mr Obama's hook, with suggestions of a moratorium (of perhaps three to six months), with permission to finish buildings already under construction. The Palestinians, however, still say they will not resume talks unless all settlement-building stops, as Mr Obama has demanded.

At least Mr Obama has persuaded Mr Netanyahu to concede the principle that the Palestinians should have a state of their own, something he had resolutely opposed in public. However, since the Israeli prime minister spat out the words "Palestinian state" (prefixed by "demilitarised") just once in a speech in mid-June, he has shown scant enthusiasm for bringing one into being.

A number of his close friends say there is no chance of it happening, anyway. In a telling vignette in July, Benzion Netanyahu, the prime minister's 100-year-old father, a historian and leading ideologue of the Israeli "Revisionist" school that promotes the idea of a Greater Israel stretching from the Mediterranean to the Jordan river, confidently assured Israelis in a television interview that his son had set conditions for the Palestinians that he knew they could never accept.

By insisting that they recognise Israel as a Jewish state as a precondition for talks, Israel's prime minister has already demanded more of the Palestinians than Mr Olmert did. Mr Netanyahu has also gone on to declare that they must recognise Jerusalem as Israel's undivided capital. This contradicts the Palestinians' passionate belief that the eastern (and once overwhelmingly Arab) part of the city would be their own state's capital.

Indeed, on the question of stopping the building of Jewish settlements in the West Bank, Mr Netanyahu's government has insisted it will continue to sanction "natural growth" across the Israeli-occupied territory. It will also encourage the continuing expansion of Jewish neighbourhoods in East Jerusalem. This, in turn, makes life more irksome for Palestinians from that part of the city, because of the rigorous and intrusive Israeli controls they are subjected to.

All the same, even if Mr Netanyahu is bent on building settlements, he has been rattled by Mr Obama's apparently equal determination to stop him. It is the first time in nearly two decades that an American president has twisted Israel's arm so hard. It is possible that something close to a freeze will be agreed

on with Mr Obama's envoy, George Mitchell. After Mr Netanyahu met him this week, he agreed to halt a building project in East Jerusalem. If the Palestinians can be convinced that settlement-building has "stopped" (Mr Obama's word), peace talks may yet resume.

Who speaks for Palestine?

Yet the Palestinians' own divisions may well be deep enough to prevent progress. For it is widely acknowledged, at least outside Israel, that no deal between Israelis and Palestinians will stick unless it is endorsed both by the Islamists of Hamas and by its secular rival, Fatah, the movement led by Yasser Arafat until his death in 2004, when he was succeeded by Mr Abbas. The two groups are at loggerheads, despite the efforts of Egypt and others to bring them together in a unity government. This would, among other things, accept all prior agreements of the Palestine Liberation Organisation, the national umbrella movement, with Israel—including recognition of it (see article).

In 2006 Hamas defeated Fatah in a general election, getting 44% of the votes to 41%, winning a large majority of seats in the Palestinians' parliament. But because Hamas refused to recognise Israel or disavow violence, its government was isolated by Israel, with the endorsement of America and a Quartet of countries and organisations, including the UN, the EU and Russia. A year-and-a-half later, after a short-lived spell in coalition with Fatah, Hamas violently took over the Gaza Strip. Complaining about the countless rockets that the Islamist group was firing into Israel, last December Mr Olmert's outgoing government launched a fierce assault on Gaza, which left at least 1,200 Palestinians and a dozen Israelis dead. But Hamas's control over the territory has not wavered.

In the past few weeks, blood between the Palestinian rivals has been as bad as ever, with Hamas arresting scores of Fatah people in Gaza, while Fatah returned the compliment in the West Bank. Each side is accused of torturing its prisoners.

Yet, as Mr Obama changes the mood and raises expectations, prominent Palestinians on both sides realise that only if they accommodate each other will they have a chance of getting a state for themselves. Amid massive doubts, Fatah insists it is about to hold a party congress in Bethlehem, on the West Bank, to produce a more dynamic leadership; it would be Fatah's first such event in 20 years.

In January the Palestinians are due to hold presidential and parliamentary elections. Pollsters, who have not always been accurate in their predictions of Palestinian voting, say Fatah should win. A recent poll gave it 35% to Hamas's 19%. The Islamists may be even less popular in Gaza, where some blame them for the grievous suffering under Israel's continuing blockade.

Mr Abbas might win the presidency against Hamas's Gaza-based prime minister, Ismail Haniyeh. But if Marwan Barghouti, a charismatic Fatah man now in an Israeli jail, could run, he would handily beat them both. He would also have a better chance of conciliating Fatah and Hamas—and a better one of striking a deal with an Israeli government.

The two-state idea will not come to fruition, certainly not in the next few years, unless the Israeli government sincerely wants it to, and unless Palestinian leaders settle their own differences in the interests of their people. Mr Mitchell knows this. Mr Obama probably knows it too.

Mr Olmert, who came closer to a deal than anyone realised, was once a Greater Israel man. Some say Mr Netanyahu may be persuaded to follow his predecessor down the same path. Many Palestinians once believed that time was on their side and that Israel would one day disappear. Now even Hamas seems to concede that Israel is there to stay. Large majorities of Israelis and Palestinians now want two states, side by side. It is still possible that one day they will get their way.

Hamas's foreign policy

Acceptance versus recognition

Jul 30th 2009 | GAZA
From The Economist print edition

A Hamas spokesman wants Barack Obama to talk to him

"HAMAS is very close on recognition of Israel," says Ahmed Yousef, the Islamist movement's deputy foreign minister, speaking from the top floor of a high-rise building in Gaza City. "We show all sorts of ideological flexibility on this." That does not, alas, mean he can unequivocally accept the three conditions the Quartet (the United States, the European Union, the UN and Russia) laid down three years ago if Hamas is to join international negotiations. But he comes close to doing so, sounding almost desperate to stretch the semantic elastic to satisfy the doubters. It is a formulation that sticks closely to the enunciations of both Khaled Meshaal, the movement's Syria-based leader, and Ismail Haniyeh, its prime minister in Gaza.

Hamas "honours" all previous agreements of the Palestine Liberation Organisation [with Israel], which include recognition, provided the other side abides by all its reciprocal promises. Hamas is ready to extend its present "unilateral ceasefire" if the other side formally agrees to one: not exactly the Quartet's demand for a definitive disavowal of violence. And when it comes to recognising Israel, "the issue is not Israel's right to exist. We know Israel is there. It's not a matter of recognition." The distinction, it seems, is a semantic but nonetheless ticklish one: between acceptance and recognition. Some diplomats draw an analogy with the Irish republicans of Sinn Fein, who engaged in negotiations with Britain over Northern Ireland after disavowing violence, but still refused to accept the province's legitimacy as part of the United Kingdom.

Mustering his arguments, Mr Yousef repeatedly insists on Hamas's eagerness to jump into the diplomatic fray. Again echoing Mr Meshaal, he pins fresh hope on Barack Obama, copiously praising his Cairo speech to the Muslim world in June. "In general it was excellent," he says. "I do believe he's sincere. But is he ready to walk the way he talks?" Or will he succumb to "pressure from Christian fundamentalists and the Jewish lobby? We wait for facts on the ground." Mr Yousef also lauds George Mitchell, Mr Obama's special envoy. Mr Mitchell, incidentally, was largely responsible for drawing in Sinn Fein.

"Let us sit down and talk. It's unfair to place preconditions," says Mr Yousef, citing a string of UN resolutions which, he says, Israel has flouted over the years without being barred from negotiation as a result. "[The Israelis] deceive the world community by saying Hamas does not recognise Israel. We have said we accept a Palestinian state in the 1967 borders—that is 20% of the land of Palestine. Fatah [formally] recognised Israel but what did it get [in return]? We have even offered a *hudna* [truce] of 10-20 years, to build confidence, to make a better climate." Perhaps, suggests Mr Yousef, the two sides could agree to an immediate ceasefire for a year, to build on today's "period of quietness".

In any event, if Hamas is to follow suit, a number of other issues must first be tackled, says Mr Yousef. Israel, he says, must lift its cruel siege of Gaza. The building of Jewish settlements on the West Bank must stop. There must be an exchange of prisoners between Israel and the Palestinians. And Mr Obama must then call an international conference.

Mr Obama must also "boost the Egyptians to go ahead with national reconciliation between the Palestinians.""We should blame ourselves as well as others for failing to achieve national reconciliation." Mr Yousef promises that Hamas, which won the Palestinians' last general election, in 2006, would gracefully bow out of office if it were to lose next time round, maybe early next year. "We accept the peaceful rotation of power."

Repeating Hamas's argument that any Israeli-Palestinian deal should be put to all Palestinians in a referendum, including those in the diaspora, he insists that if people chose a two-state solution, "Hamas would not object", even though it would still prefer a single state for "all the Abrahamic faiths, maybe a Holy Land federation…we leave it to the next generation to decide what kind of [arrangement]".

Like most Hamas officials, he breezily dismisses the movement's charter, with its anti-Semitic slurs and its chilling calls for the Jewish state's violent destruction. It is "not an important document—we don't use it. Why should we change it when we never use it?" If Hamas wanted to show good will as part of its campaign to enter negotiations, the junking—or drastic editing—of its blood-curdling charter would be a telling token of intent.

Iran's president in trouble

Ructions at the top

Jul 30th 2009 | TEHRAN
From The Economist print edition

Mahmoud Ahmadinejad is being buffeted on all sides

AP

The president hears many voices

IT HAS been a rough fortnight for Mahmoud Ahmadinejad, Iran's beleaguered president. Mir Hosein Mousavi is proving an unexpectedly tenacious opponent, accusing Mr Ahmadinejad's government of a catalogue of crimes against the Iranian people. In a Friday sermon at Tehran University, Akbar Hashemi Rafsanjani, a former president and one of Mr Ahmadinejad's leading foes, ominously called the turmoil "a crisis". Muhammad Khatami, another former president, has called for a referendum on the disputed presidential election results. Now, only days before his inauguration for a second term, Mr Ahmadinejad has fallen out with a clutch of powerful conservatives whom he had formerly counted as allies.

The latest row revolves around Mr Ahmadinejad's short-lived appointment of a vice-president. Esfandiar Rahim Mashaei is almost part of the family (his daughter is married to the president's son), but last year he angered conservatives by suggesting that the Israeli people could be friends of Iran. So when Mr Ahmadinejad tapped him for the vice-presidency, Ayatollah Ali Khamenei, Iran's supreme leader, immediately told the president to ditch his friend. Mr Ahmadinejad sulkily acquiesced but then defiantly made Mr Mashaei his chief of staff.

The president may have been trying to show that he has a mind and a power base of his own. He may also have been seeking to mollify his reformist opponents by showing the world that he is not quite as fanatical about Israel as he has often sounded. If that was his plan, it flopped. After failing to secure his own man as vice-president, he lost his minister of culture and Islamic guidance, who promptly resigned. Mr Ahmadinejad then fired his intelligence minister, who had criticised Mr Mashaei's appointment.

At Friday prayers a week after Mr Rafsanjani's hostile intervention, the president then caught a blast of cold air from one of his conservative supporters, Ayatollah Ahmad Jannati, who heads the powerful Guardian Council. He cautioned Mr Ahmadinejad against rubbing up Mr Khamenei the wrong way. Some have argued that the supreme leader has looked weaker in the past few weeks, but this episode is a reminder that he still wields a lot of clout. Following Mr Jannati's comments, two-thirds of Iran's parliament, which has tripped up the president before, signed a letter telling Mr Ahmadinejad to sort himself out and to do Mr Khamenei's bidding.

It is by no means the first time Mr Ahmadinejad has faced opposition from within the conservative camp. His bombastic millenarian populism has long irked his more pragmatic conservative allies. Hardliners are not always keen on him either. At least one group with links to the *baseej* militia has said it wants to wrest power from Mr Ahmadinejad, offering its own preferences for government posts.

In the past the president has been cushioned from criticism by Mr Khamenei's steady support. It is said that Mojtaba Khamenei, the supreme leader's power-broking son who apparently has pretensions to succeed his father, broadly backs Mr Ahmadinejad. So the president still has powerful allies. Even so, just now these latest ructions within the establishment may matter more for Iran's future than protests on the street.

Iraq's Kurdish election

The times they are a-Changing

Jul 30th 2009 | SULAYMANIYAH
From The Economist print edition

A new party dents a Kurdish duopoly. But does it bring independence closer?

Reuters

Barzani gives them the finger

THE Kurds still have a dream. One day most of them hope to cut their ties with Iraq and end their lot as the largest stateless people in the Middle East by establishing a sovereign Kurdistan, starting with what is now northern Iraq. (There may be 24m Kurds, all told, living mainly in four countries in the region: Iran, Iraq, Syria and Turkey.) Arab Iraqis reject this dream, fearing that Kurdish secession would destroy their country and, by the by, cost it a lot of oil. So, under American pressure, in 2003 they granted the Kurds some autonomy, which the Kurds have cherished; the Arabs hoped it would be enough to placate them. But every little shift in Iraqi Kurdish politics is judged by whether it brings sovereignty closer. Whether regional elections on July 25th have done so is open to question.

What is indisputable is that the Kurds' two-decade-old experiment with democracy has passed a milestone. For the first time, their regional parliament in Erbil will have a real opposition. The Change movement, a collection of civil-society campaigners, won about a quarter of the seats, and other opposition groups notched up at least 15% of them, ending the parliament's reputation as a rubber stamp. "Change is here to stay," says Asus Hardi, an independent editor.

Part of Change's appeal is its demand for more autonomy. But the main reason for its success is its opposition to the perceived corruption of the two main parties. Many Kurds have been disgusted by the extent to which people tied to the ruling clans, the Barzanis and the Talabanis, have lined their pockets. Despite regular elections since 1992, the two have acted in a quasi-feudal fashion, controlling a lion's share of business while also running security. Even after losing almost a third of their seats, they will still be able to form another government, having run in the election on a joint list.

Masoud Barzani was comfortably re-elected as the region's president. But the old spoils system, run by his Kurdistan Democratic Part (KDP) and the Talabanis' Patriotic Union of Kurdistan (PUK), may be beginning to break down. The two clans' power, especially that of the Talabanis, from whose party the Change movement was mainly drawn, has been weakened. The PUK may even start to fade. And the Talabanis' old rivals, the Barzanis, may now face unprecedented and unwelcome scrutiny of their finances.

As an exercise in democracy, the election was far from perfect. Change credibly alleged large-scale voter fraud. At polling stations KDP people wearing the Kurds' traditional baggy trousers and embroidered sashes danced away, while behind the scenes their colleagues are said to have stuffed ballot boxes. Some clan loyalists are said to have voted 20 times. Yet the electoral commission, dominated by the two old ruling parties, was unmoved.

Even so, Change did pretty well. As a result, KDP supporters smashed the offices of opposition groups in Erbil, the Kurdish capital and the KDP's biggest fief. One person is said to have been killed and a dozen hurt. Independent journalists say they fear retribution by the Kurds' security forces, which are dominated by the two old parties. "There could be assassinations," says Ahmad Mira, an editor at *Lvin* magazine. One of his reporters was murdered last year, apparently for digging too deep.

Once proud of being a model for democracy in Iraq, some Kurds now worry that the "democracy gap"

with the Arab Iraqis has been narrowed. Moreover, Iraq's prime minister, Nuri al-Maliki, has already begun to play the Kurds off against each other, diminishing their influence in the central government in Baghdad. Jalal Talabani, the PUK's founding leader, who has been Iraq's national president, may have to cede his job next year to a Sunni Arab. Mr Talabani has been a proponent of compromise. So his departure could hurt the chances of resolving the Arab-Kurdish dispute over land and oil in the border region around Kirkuk, a city and province which the Kurds say is theirs. The old duopoly's weakening could make it still harder for the Kurds to get closer to independence.

In any event, their mood is hardening. Sadi Pire, the PUK's head of public relations, says, "Don't underestimate our fighters. Saddam did that and you've seen the result." While they often worry about what is going in Baghdad, many Kurds also worry that their foreign sponsors may betray them, as they have several times in the past century.

As Kurdish-Arab relations in Baghdad worsen, the Americans may be starting to lean towards the more important of the two sides: the Arabs. General Ray Odierno, the American commander in Iraq, has called the Arab-Kurdish dispute "the number one driver of instabilities" in Iraq. Mr Barzani, following his re-election, said he rejected UN proposals for sorting out the territorial row. Robert Gates, the American secretary of defence, flew to Iraqi Kurdistan to talk to Mr Barzani after the poll.

In sum, a durable settlement between Iraq's Arabs and Kurds looks no closer. In the short run, the Kurdish election result may lead to a period of instability among the Kurds themselves, which is unlikely to tilt them—or the Arabs in Baghdad—towards compromise.

Sudan's border dispute over Abyei

Do they agree? Yes, no, and sort of

Jul 30th 2009 | JUBA AND KHARTOUM
From The Economist print edition

A ruling from The Hague pleases the north and vexes the south

OFFICIALS in Sudan's government in Khartoum could hardly believe their luck when, on July 22nd, the Permanent Court of Arbitration in The Hague ruled on the fate of the disputed Abyei state, which sits astride the oil-soaked border between Arab northern Sudan and the ethnically African (and largely Christian) south Sudan. Surprisingly, the court reversed an earlier commission's ruling and redrew Abyei's borders, snipping out the lucrative Heglig and Bamboo oilfields (see map) and giving them to the north.

The ownership of these oilfields has soured relations between the north and south Sudanese ever since a peace accord was signed between them in 2005, ending a civil war that had raged on and off for nearly half a century at a cost of some 2m lives. So tense had the situation in Abyei become that last year much of its capital was burned to the ground in fighting between militias from the two sides. Now, however, the north seems to have got what it wanted by law rather than by force.

The head of President Omar al-Bashir's National Congress Party delegation in The Hague, Dirdeiry Muhammad Ahmed, said it was a "great achievement" that ownership of the oil had been settled "without conflict". However, perhaps intoxicated by victory, he then stirred a bit of animosity by suggesting that the government in Khartoum would stop paying half of the oil revenue from Heglig and Bamboo to the south, as it must do under the 2005 peace deal. As South Sudan's government relies on oil for almost all of its revenue, these comments were bound to provoke. Other northerners were more conciliatory. In any case, the north's true position will become clearer after a technical committee of north and south begins work on the border's final demarcation.

Ministers in South Sudan's capital, Juba, at first claimed they had "won the case", then grew puzzled. Then a sense of vertigo set in; perhaps the north had "won" after all. For southerners looking forward to independence, the thought of losing any oil is upsetting. That may explain why this week the south began to claim that the Heglig field has not been granted to the north at all but is still in the south because it extends into Unity state. This blithely contradicts the case South Sudan made at The Hague. "It's a rather desperate measure," admits a well-placed southerner. Even if the south has no chance of winning the oil back, it may drag out legal proceedings to satisfy its hotheads at home.

At least the court ruling pleased the Ngok-Dinka people. When the south votes in the 2011 referendum, Abyei state will exercise a special dispensation (which is nothing to do with the ruling at The Hague) letting it choose whether to stay in a federal Sudan or to secede with the south. As the state is now smaller within its new boundary, the Ngok-Dinka is the dominant tribe in it—so their vote will probably ensure that Abyei goes to the south.

Yet oil has blinded both sides to the question of land. Heglig and Bamboo produce low-quality crude. Oil men say their production is dropping off quickly, to 53,000 barrels a day. That could reduce revenues to less than $300m a year by 2011—hardly enough to go to war over. It is access to land that has always been the more combustible issue in this part of the world.

The Misseriya people, who are Arab pastoralists, had hoped the ruling would give them the right to run their cattle freely through Abyei, as they have long done, often in violent opposition to the sedentary Dinka people. Yet under the court's ruling, the Misseriya may now have to pay grazing fees to the Dinka. A dissenting Jordanian judge on the arbitration court said the ruling makes the Misseriya "second-class

citizens on their own land and creates conditions which may deny them access to water." Some Misseriya protested after the ruling. Usually allies of the government in Khartoum, and sometimes its proxy fighters, they say they have been betrayed for a few dry oil wells.

So a mess prevails. People now look forward to the demarcation of electoral districts and the rest of the north-south border for national elections next year and then for the referendum. Both north and south appreciated the openness and speed of the court's mediation. Some say it could be a model for solving the many other outstanding issues between the quarrelsome Sudanese. If only.

Islamist attacks in Nigeria

A taste of the Taliban

Jul 30th 2009
From The Economist print edition

An Islamist insurgency in the north comes on top of another in the Delta

VIOLENCE has often disfigured religion in Nigeria. Usually, it has been a matter of bloody confrontation between Muslims and Christians in the middle of the country, where the largely Muslim north rubs up against the mainly Christian south. This week, however, Nigeria experienced its most serious outbreak of another kind of religious violence, provoked by Islamic fundamentalists who take their inspiration from the Taliban of Afghanistan. At least 180 people were killed in five days of clashes between militants and the police.

The fighting started on July 26th in Bauchi state after the police arrested several suspected leaders of an Islamist sect called Boko Haram, a local Hausa term that means "education is prohibited". In particular, the group is against Western education and influence. It wants to impose a pure Muslim caliphate on Nigeria. In retaliation for the arrest of their leaders, militants went on the rampage in several northern states, attacking the police with anything that came to hand, from machetes to bows and poison arrows.

The police fought back, killing, so they claimed, 39 militants in Bauchi. Fierce fighting took place in Maiduguri, capital of Borno state, where the sect has its headquarters. On July 28th the army was called in to shell the compound where the sect's leader, Muhammad Yusuf, has been based. As well as killing scores of Boko Haram fighters, the police arrested hundreds of suspected members of the group.

The "Black Taliban", as such groups are dubbed in Nigeria's northern states, have carried out isolated attacks for several years. This time the violence has been more widespread and prolonged. Muslim *sharia* law was introduced in 12 northern states after general elections in 1999, but the states' Muslim rulers have usually been cautious in applying it. This has prompted the militants to demand a more extreme form of Islamist rule and for *sharia* to be extended to the whole of Nigeria.

Nigeria's federal government, along with Western intelligence agencies, has long worried that extremist groups in the north may link up with Islamist terrorist groups elsewhere in Africa, in particular with al-Qaeda in the Maghreb. This outfit grew out of the blood-soaked struggle by Islamists to overthrow Algeria's government in the 1990s. Such connections raise the spectre of a concerted Islamist threat against Nigeria, a close ally of America and a large oil exporter. But the links have not been proved and little is known about groups such as Boko Haram.

On this occasion Nigeria's president, Umaru Yar'Adua, acted swiftly. But it was the exception to his presidential rule. Now halfway through his four-year term, the former governor of the northern state of Katsina has achieved little. His administration is beset by indecision and drift.

This week's violence in the north comes on top of unceasing violence in the southern Niger Delta region, where an insurgency by militants demanding a bigger share of the country's oil wealth continues to disrupt oil exports. By some estimates, Nigeria now exports only half of what it should: Angola has taken over as sub-Saharan Africa's biggest producer.

Despite floating various well-meaning plans to pacify the Delta, the government has failed to stop the region's unrest. The fall in tax revenues, as a result of illegal bunkering and the sabotage of pipelines, means that Mr Yar'Adua has even less chance of tackling his country's other problems, such as a chronic lack of electricity. The insurgency in the Delta has thrived on the back of dire poverty and high unemployment in what should be a relatively wealthy region, were it not so poorly governed. Some fear the Islamist militants in the north may profit from the same lack of opportunities, which saps the morale of young Nigerians and makes so many of them prey to extremists.

The euro-area economy

First, the good news

Jul 30th 2009
From The Economist print edition

The economy has probably seen its worst, but a strong recovery may be too much to ask for

Illustration by David Simonds

AT THE beginning of June Jean-Claude Trichet, the head of the European Central Bank, set out its latest forecasts. Though the worst of the downturn had probably passed, he said, the euro-area economy would be unlikely to grow until the middle of 2010. Just a few weeks later Mr Trichet looks too gloomy. Figures published on August 13th are likely to show that GDP shrank again in the second quarter, but that this will probably be the low point.

More timely indicators suggest the economy has started to grow again. Businessmen are cheerier. The gauge of German business sentiment published by Ifo, a research institute in Munich, rose in July to its highest level for seven months. Confidence in France increased for a fourth straight month, according to a survey by INSEE, the national statistics agency. The brighter mood reflects orders and sales. Euro-zone industrial output rose in May for the first time since September. A broader index, based on surveys of purchasing managers in manufacturing and services, was much stronger in July.

This revival of animal spirits counts because so much of the downturn owed to a collapse in business spending. Firms slashed their capital budgets and pared back stock levels when their export sales collapsed. Foreign demand is now returning. Euro-zone exports to China rose by over 40% between January and June, according to Goldman Sachs. Shipments to India have also picked up. Orders in Germany are improving as its capital-goods firms benefit from infrastructure spending in Asia. The fresh signs of life in America’s housing market raise hopes that recession is lifting in Europe’s biggest export market.

Consumers are also perking up, though compared with firms they had barely cut back. In the year to the first quarter, the worst period for the economy as a whole, consumer spending in the euro area fell by 1.2%, less than in America and far less than in Britain. That figure conceals a split: consumption in Germany was stable, and in France, it grew; but in Italy and Spain it fell off sharply. Spending in the euro

zone as a whole has since strengthened, though the North-South divide remains. Retail sales picked up in Germany in April, and again in May, but faltered in Spain and Italy. In France household spending on manufactured goods jumped by 1.4% in June. Government incentives to support new car sales by offering cash for old ones have tempted buyers into showrooms. Spending power has also been boosted by falling consumer prices.

Three (modest) cheers

A revival in trade, business optimism and resilient consumers: that combination promises modest growth this quarter. There may even be some pleasant surprises in the next few months. Germany's economy could bounce back faster than expected, because its cuts in business investment and stocks have been so savage.

But the good news ends there. One worry is that more pain is due in Spain, Italy and elsewhere. The surprisingly large fall in second-quarter GDP in Britain is a blow to its euro-zone trading partners. It is also a warning that recovering from housing and credit busts is hard. Spain and Ireland were big sources of euro-zone demand, before their housing busts. Spain will soon find it harder to offer fiscal support to its economy. Italy's exporters are struggling with high wage costs and a strong euro. Eastern Europe, once a fast-growing market, is also sickly.

The longer-term fear is that unemployment will drag the economy back down. The risk is greatest in countries where job cuts have so far been modest. Compared with Spain, where a nasty construction bust has already put many out of work, the jobless rates in France and Germany have barely responded to lower output (see chart). German job losses have been stemmed by a government scheme that subsidises the wages of those on short-time working. Around 1.4m workers are receiving the short-time allowance. The reduction in labour supply because of the scheme is equivalent to some 400,000 full-time employees.

Such schemes cannot last for ever. Car firms and their suppliers have been among the keenest users of short-time working, anxious to keep skilled staff. Yet unless demand for cars stays high after "cash-for-clunkers" incentives fade, the car industry in Europe will need fewer workers.

Similarly, labour hoarding in France also comes at a cost. French firms in aggregate still spend more than they earn, despite cuts in investment. Action taken to bridge that gap while financing conditions are still tight would include job cuts. As in Germany, that process could be slow and rely more on hiring freezes than lay-offs, says Julian Callow at Barclays Capital. But it would weigh on consumer demand all the same. Although Europe shows signs of recovery, there are plenty of reasons to fear it will not be a robust one.

Spanish devolution and the budget

All must have prizes

Jul 30th 2009 | MADRID
From The Economist print edition

Everyone’s a winner in Alice in Zapateroland

AFP

And my deficit is just this big

AFTER a year of mudslinging and recrimination, Spain’s prime minister, José Luis Rodríguez Zapatero, has finally worked out how to stop regional governments squabbling over the shrinking pot of public finances. The solution is simple. They can all have more.

An extra €11 billion euros ($15.6 billion) will be distributed, marking another step in the march of power away from Madrid towards the country’s 17 regions. With the budget deficit already ballooning, the deal will make sound economic management still harder.

Even those regions run by the opposition People’s Party (PP), which include Madrid and Valencia, did not vote against the offer. They abstained. They do not like the new system but, facing economic problems of their own, prefer to take the money. The deal is frustratingly vague about numbers, though some regions, such as Catalonia, will be bigger winners than others. It is the financing model that best reflects the reality of Spain, said Mr Zapatero.

So if everyone is a winner, who loses? The central government will have less, says Jesús Fernández-Villaverde, of the University of Pennsylvania. Economists think the deal will increase the budget deficit—already heading towards 12% of GDP—by one percentage point. The finance minister, Elena Salgado, admits the deal will increase the central budget deficit a bit, but argues it will mostly transfer existing debt from the regions to the central government. Future taxpayers are losers too, as they must pay off Spain’s debt in the long term.

For the moment, Mr Zapatero looks like the winner. At elections last year, his Socialist Party fell seven seats short of an absolute majority. Many of the extra parliamentary votes Mr Zapatero needs are in the hands of small regional, nationalist or separatist parties. There is no better way to keep them sweet than to increase funding for their home regions.

The new deal certainly reflects one of Spain’s new realities: the big spenders of public money are regional governments, who run education, health and myriad other services. It did not, however, fix one big problem. Regional governments may decide where a lot of the tax money goes, but have little influence over how it is raised (except in the Basque Country and Navarra, which remain outside this deal). So there is less pressure on them to be efficient.

The spread of devolution has been a game of follow-the-leader: independent-minded regions such as the Basque Country and Catalonia show the way; the others demand equal treatment. The latest financing rules are, in many ways, a result of Catalonia’s statute of autonomy, passed by the Socialists in 2006. Under Mr Zapatero, devolution continues apace. What no one can say is where, or when, it will end.

Visas in the Balkans

Passport woes

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When visa requirements are relaxed tensions can mount

EVERY summer millions of young folk explore Europe using cheap, continent-wide rail and bus passes. Thanks to a new visa-free deal, more of those strumming guitars on the Ramblas in Barcelona or the Spanish Steps in Rome should soon hail from parts of the former Yugoslavia—but not yet from all of the western Balkans. That is creating political tensions.

For years visas have been a neuralgic issue in the region. So a recent recommendation by the European Commission to scrap visas for Serbs, Montenegrins and Macedonians from the start of 2010 should be good news. If it takes effect, it will give people in these countries free access to the Schengen area of 25 countries, including almost all EU members plus Switzerland, Norway and Iceland.

Before the wars of the 1990s Yugoslavs did not need visas to travel to the rest of Europe. Today it is said that 70% of students at Belgrade University have never been abroad. For years EU foreign ministers have been berated about this by their Balkan colleagues. Their answer has often been that, if it were up to them, all would be fine. But interior ministers, fearful of organised crime and drug- and people-trafficking, refuse to agree. The counter-argument has been that criminals will hardly wait in line for visas they can buy or forge, so visa rules merely punish ordinary folk and legitimate businessmen.

To achieve visa abolition has taken a huge amount of work, the introduction of modern biometric passports being only a first step. Already the political fallout of the decision is being felt. In the Balkans visas and passports are not a mere technicality, but the stuff of high politics. And the commission’s decision means that Bosnians, Albanians and Kosovars feel left behind.

There is particular bitterness within Bosnia. Bosniaks (Bosnian Muslims) cannot travel freely, but Bosnian Croats can because they have long used Croatian passports, for which visas were abolished some years ago; Bosnian Serbs may now apply in large numbers for Serbian passports. All this weakens Bosnia’s fragile statehood. It is outrageous, say Bosniaks, that a fugitive like Ratko Mladic, indicted for murdering some 8,000 Bosniaks in Srebrenica in 1995, is now in theory able to travel freely on a Serbian passport whereas the relatives of his victims cannot.

Still, Bosnians and Albanians know that it is only a matter of time before they too qualify for visa-free travel. Not so the Kosovars, who have yet to start working on the issue with the EU. Matters are complicated by the fact that, because Serbia does not recognise Kosovo’s independence, it cannot refuse to give Serbs and Albanians living there its new biometric passports. But as part of the deal on visa-free travel for Serbia, the EU excludes them.

Hence a Serbian passport for somebody in Kosovo will be worth less than one for a Bosnian. And if Serbia and Croatia can hand out passports in Bosnia, why should not Albania issue passports to Kosovar Albanians? Some people may even start to ask why the Albanian nation should be split between two states. Bureaucratic anomalies can have mighty consequences.

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EUROPE

Language rows between Slovakia and Hungary

Hovorte po slovensky!*

Jul 30th 2009 | BRATISLAVA
From The Economist print edition

Slovakia criminalises the use of Hungarian

Illustration by David Simonds

LANGUAGE laws may protect minority rights or infringe them. Slovakia's new law, which comes into force on September 1st, is under fire for its harshness. It imposes fines of up to €5,000 ($7,000) on those who break rules promoting the use of Slovak in public. Hungarian-speakers, who number around a fifth of the population, mainly in the south of the country, see that as a direct attack on their right to speak their mother-tongue. So do politicians in neighbouring Hungary. A long-running dispute between two of Europe's most prickly neighbours is turning nasty.

Slovakia's left-leaning populist government has been needling Hungary since it took power in 2006. It sidelined plans for a joint Hungarian-Slovak history textbook last year and has publicly endorsed the Benes Decrees, which expelled most Germans and many Hungarians from the then Czechoslovakia after 1945, as a punishment for their supposedly Nazi sympathies. The new law tightens rules about speaking Slovak in dealings with public officials: not just police officers or teachers, but also, say, doctors. Exceptions apply to monoglots, or in districts where the minority makes up a fifth or more of the population. Hungarian-language schools must conduct their administration in Slovak. The new law also lays down detailed instructions for the way in which memorials and plaques may be inscribed.

A party representing the Hungarian minority is mounting a challenge in the constitutional court: it calls the law "19th-century language imperialism". The Slovak response similarly accuses the Hungarians of hankering for the 19th century: they dominated the region in the Habsburg era. The Slovak prime minister, Robert Fico, said the real problem was those wanting to bully Slovaks in the south of the country into learning Hungarian.

The Slovak foreign ministry has published (unilaterally) an expert opinion drawn up in confidence by Knut Vollebaek, high commissioner for national minorities at the Organisation for Security and Co-operation in Europe, a Vienna-based international organisation. Mr Vollebaek agrees that the bill does not in itself contravene international law or Slovakia's earlier commitments to protect minority languages. But his opinion also highlights concerns over the hasty passage of the new legislation and the danger that it may be interpreted arbitrarily.

The big question is the meaning of the requirement that Slovak be used "in public". Would, say, a Hungarian-speakers' poetry club have to arrange for their meetings to be translated into Slovak? Perhaps not, but it is an odd thing to have to worry about these days in the European Union.

Grandstanding in the run-up to elections has fuelled the row. Mr Fico is gaining record popularity ratings. It helps divert opinion from issues such as corruption and economic decline. Mikulas Dzurinda, a former prime minister and opposition leader, says that the real danger to the Slovak language comes not from tongue-tied ethnic Hungarians, but from the debasing of Slovak by foul-mouthed chauvinists in the government, such as the leader of the Slovak National Party, Jan Slota. He recently provoked uproar by calling a policewoman (she says) a "cunt". The charming gentleman's complaint? She had refused to allow his driver unauthorised entry to a parliamentary garage.

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*Speak Slovak!

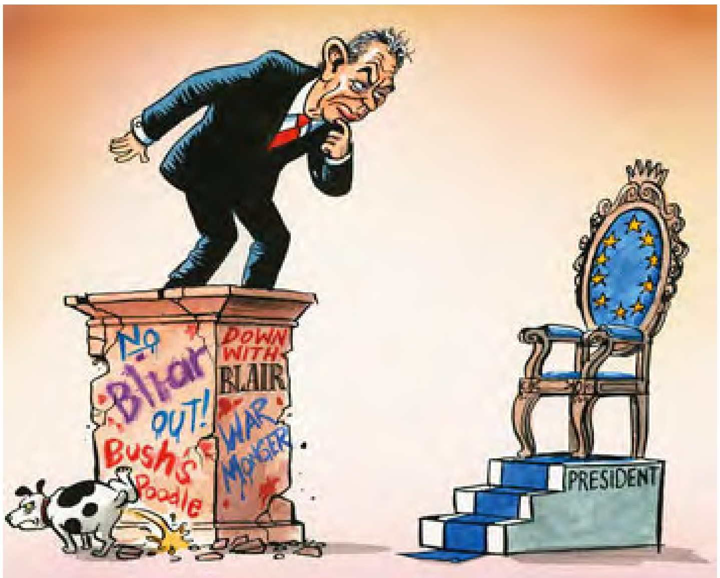
Charlemagne

Unwelcome, President Blair

Jul 30th 2009
From The Economist print edition

Europe does not yet know what kind of foreign policy it wants. It may soon have to choose

Illustration by Peter Schrank



WHY does the thought of a "President Tony Blair" in Europe make people so cross? Something about the idea sends prominent euro-politicians into paroxysms. Take Daniel Cohn-Bendit, co-leader of the Green faction in the European Parliament: he calls a Blair candidacy "absurd", damning him as a zealous advocate of the Iraq war that divided Europe, and blaming him for "Thatcher-inherited neoliberal politics" that sowed the seeds of today's economic crisis.

The holder of the new position, to be created by the much-debated Lisbon treaty, would speak for the 27 national leaders and chair their summits for a term of two and a half years, renewable once. The job is not "President of Europe", as some call it, but president of the European Council, the bit of the EU controlled by national governments. The holder will have to work with the European Parliament (which hates the Council) and the European Commission, a hybrid executive bureaucracy.

Apart from Mr Blair, other possible candidates mooted so far include Felipe González, Paavo Lipponen and Wolfgang Schüssel, ex-government heads from Spain, Finland and Austria respectively. None triggers the same reactions as Mr Blair. He is the only prospective candidate with his own protest website, www.stopblair.eu, signed to date by 32,000 people.

Why such animus? Doubtless some people think Mr Blair loathsome, even wicked, for his actions as Britain's prime minister between 1997 and 2007. But that is not a common view among the senior European politicians and officials who also oppose him. Something else is at work: a telling rejection of what a President Blair would say about the EU, and its foreign-policy goals.

Oddly, Mr Blair is not even a confirmed candidate. But last month Britain's minister for Europe, Glenys Kinnock, caused a sensation when she was quoted as implying that he had Britain's official backing. This undammed a torrent of hostility. Continental commentators sniffed that Mr Blair was a phoney, who called himself a European but never made the British love Europe (they should try). British newspapers lazily declared that Mr Blair was in it for the salary and perks, and called his successor, Gordon Brown, "Machiavellian" for promoting his cause. Alas, the story was untrue. Lady Kinnock, a former member of the European Parliament, had been a minister for about five minutes when she was asked about Mr Blair. Winging it, she called him her government's candidate; this was a blunder, not a clever ploy.

The episode did Mr Blair no favours. But it may have done the EU a good turn. It is time that Europeans had a proper debate about the global presence they want. The Lisbon treaty creates two big new foreign-policy posts. Apart from the council president, there will also be a beefed up “high representative”, a kind of foreign minister who will chair meetings of EU foreign ministers (ie, will have political power) and be a vice-president of the European Commission (ie, will have pots of money, thousands of staff and offices round the world). Possible contenders include Carl Bildt, Sweden’s foreign minister, who says he does not want the post, and Olli Rehn, the Finnish enlargement commissioner, who probably does. Some talk of Dora Bakoyannis, foreign minister of Greece, or Ursula Plassnik, an ex-minister from Austria.

Most people in Brussels are confident (indeed, overconfident) that the two new jobs are coming soon. Conventional wisdom says the Irish will be sufficiently cowed by the economic crisis to vote Yes to Lisbon in early October, allowing EU leaders to discuss the new jobs at a summit later that month. Remarkably, most other details have not been nailed down. Lisbon is silent on the question of how the council president and high representative will avoid getting in each other’s way.

Inside the Brussels bureaucracy, the view is that the high representative will be the more powerful figure; the post’s budget, staff and institutional reach count for more than the fancy title of “president”. In Paris and London, by contrast, the view is that the council president, as the envoy of national leaders, takes primacy. France’s president, Nicolas Sarkozy, has in the past suggested Mr Blair would make a fine president. Of late he is reported to have cooled on the idea, although he would still want a big hitter.

France sees Europe as the lever for achieving global clout. For all its wariness of Europe, Britain’s position is not that dissimilar. It sees the EU’s population of 500m people and its economic heft as a route to relevance on issues such as climate change. As David Miliband, Britain’s foreign secretary, said in June, if Europe wants to avoid a “G2 world” shaped by China and America, the EU needs to offer itself as a partner for “G3 co-operation”.

Big power, soft power or no power?

This matters. If great-power diplomacy is Europe’s goal, it needs a council president who is seen as a peer by world leaders (well hello again, Tony). But not everyone agrees. Senior figures in the Brussels foreign-policy establishment (and in Germany) argue that the EU enjoys “moral and legal legitimacy” precisely because its overseas actions are not based on the interests of a few big states, but are approved by consensus. Smaller countries say similar things, mainly out of fear of being bullied by big members. Fredrik Reinfeldt, the prime minister of Sweden, holds the rotating presidency of the EU. He says small and medium-sized countries “are not interested” in an over-strong president; he prefers to speak of a “council chairman” rather than a president.

In the end the decision may be taken by default. EU jobs are awarded in long, unpredictable horse-trading: leaders may give one job to a star, and the other to a plodder, thus fixing their relative clout. If it were to be, say, President Schüssel and High Representative Bildt, the high representative would run foreign policy. If the EU ends up with two plodders, irrelevance beckons.

Economist.com/blogs/charlemagne

Gennady Timchenko and Gunvor International BV

Jul 30th 2009
From The Economist print edition

In a section of our special report on Russia entitled “Grease my palm” (November 29th 2008) we referred to Gunvor and its cofounder, Gennady Timchenko. We are happy to make it clear that when we referred to the “new corruption” in today’s Russia, we did not intend to suggest that either Gunvor or Mr Timchenko obtained their Russian oil business as a result of payment by them of bribes or like corrupt inducements. Rosneft sells only 30-40% of its oil through Gunvor rather than the “bulk” of Rosneft’s oil (as we described it). We accept Gunvor’s assurances that neither Vladimir Putin nor other senior Russian political figures have any ownership interest in Gunvor. We regret if any contrary impression was given.

The quality of teachers

Those who can

Jul 30th 2009 | CANTERBURY
From The Economist print edition

Education reforms will never work unless teaching attracts more high-fliers

Report Digital

"I SET up a Fantasy Football competition between some of my toughest pupils," one young man explains. "They get goal-keeping points for good attendance, and defence points for behaving well. Good punctuation and spelling translate into their midfield performance, and coming up with good ideas, into attack." Around the room, pens scribble furiously. "Pupil X hated me," a woman tells the group; she describes how she changed that with weekly phone calls to his parents and postcards praising his (intermittent) good behaviour. More notes are made.

This is the Teach First summer institute: six weeks in Canterbury, a southern cathedral city, at the end of which nearly 500 new university graduates will teach full-time, for £15,000 ($24,500) a year, in some of England's toughest schools. The 360 who started the programme last year are here too, handing on to the raw recruits their tips for coping with bad behaviour and keeping lessons fresh, and demonstrating to their tutors what they have learned. In another year, those old hands will be qualified teachers, trained on the job and in tutorials and summer schools.

Recruiting the right kind of teachers has been difficult in England for some time, and though recession has brought temporary relief, the task is getting bigger as those hired to teach the baby boom near retirement. Head teachers, worn down by constant official policy changes and an avalanche of paperwork, are retiring early. A study in 2007 by McKinsey, a consultancy, concluded that countries whose students perform well tend to recruit teachers from the top of the class. But a recent report by Politeia, a think-tank, found that the bar for getting into teacher training in England is, by international standards, unusually low. Trainee teachers can resit basic literacy and numeracy tests as often as they like—and 13% need at least three goes at the latter. Around 1,200 each year graduated with the lowest class of degree, a third.

The result is a general sense that the country's teachers have been scraped from the bottom of the barrel. That makes it unlikely that ambitious graduates will consider joining the profession, or stay in it if recession persuades them to do so briefly.

Modelled on Teach for America, a programme founded in 1989 that now trains 4,000 teachers a year, Teach First aims to reverse this vicious cycle by creating a route into teaching for high-fliers. Applicants

are screened for leadership and communication skills, and the successful ones promise to teach for two years in “challenging” schools: those where few pupils get good exam results or where more than 30% are poor enough to receive free school meals. Such schools tend to have the least qualified teachers and to suffer from high turnover. One summer-school participant is about to start teaching mathematics to 15-year-olds who have had 22 teachers in the subject in the past three years.

Unlike government recruitment drives, which tend to present teaching as appealing, even easy, Teach First describes the job as tough and demanding because the right people are those who are attracted by the most daunting tasks. Few at the Canterbury summer school think they would have considered teaching without that approach: the standard one-year postgraduate course is, they say, “too slow”, “too theoretical” and “boring”. Strong links with businesses, including prestigious graduate recruiters who often scoop up those who decide not to stay in teaching, help bring them in too. Some employers, like HSBC, a bank that is one of the charity’s biggest donors, guarantee those who leave after their two years a first-round interview.

Since 2003, when it received 1,300 applicants for just 200 places, Teach First has grown fast. Nearly a tenth of Oxford’s class of 2009 will be Teaching First this autumn. The programme already has its first head teacher, Max Haimendorf, hired to lead a new school in London after just three years teaching. It expects to take on 850 recruits in 2012, making it one of Britain’s largest graduate recruiters. To date almost three-fifths have stayed on after their two-year stint, which means that retention of teachers is almost as good as with traditional routes into the classroom.

Around 40,000 people train to teach each year in England. Making Teach First the main way to do so would dilute the programme’s prestige—and there probably aren’t enough adrenalin junkies out there, anyway. Rather, the programme hopes to change the profession less directly. As Teach First becomes better known, teaching will start to be seen as a job for ambitious go-getters. It should help with the shortage of school heads, too. And if the Conservative Party wins the next general election, as seems likely, Teach Firsters may help to make its slightly half-baked plans to open hundreds of new schools a reality. Brett Wigdortz, the charity’s founder and chief executive, says that many participants tell him they would be keen to set up and lead new schools.

Those who do not stay in education will also be influential. Business leaders are apt to bemoan the awfulness of Britain’s school-leavers, but since few went to sink schools themselves, or send their own children to them, the remedies they prescribe are not notably informed. That should change as more executives are drawn from the programme’s ranks.

Teach First’s most important contribution, though, may be to shake up education research and policy. “New teachers bring fresh eyes to education,” says Mr Wigdortz. “Our chair of trustees, Dame Julia Cleverdon, often tells participants to keep a notebook and write down everything that strikes them as crazy in the first few months—because a year in, those things will seem normal. And two years in, when they have gained in experience and confidence, they should get that notebook out and start changing those things.”

Almost all education-policy documents and research papers these days start with a reminder that a child’s family background is by far the strongest influence on his educational achievement. This evident truth could spur teachers to greater efforts to lean against that wind; instead, it is generally used to explain away poor children’s weaker performance. Teach First challenges such defeatism. “We believe educational inequity is a solvable problem,” says Mr Wigdortz, “and that the way to solve it is to get the best people teaching in the most challenging schools.”

To hear an interview with Max Haimendorf of Teach First go to
Economist.com/audiovideo/britain

Army compensation

Lions led by accountants

Jul 30th 2009
From The Economist print edition

Ministers have an inexplicable tin ear when it comes to the armed forces

Reuters

A long way home, and to what?

IT IS hard to think of a more combustible topic than Britain's foreign wars. Patriotism and appreciation for soldiers doing the dirty work wrestle in the popular breast with anger over official mishandling of conflicts seen by many as an illegal and costly mistake (Iraq) or an unwinnable misadventure (Afghanistan). Ever-bigger crowds turn out to greet the bodies of soldiers coming home for burial: four more returned on July 28th. That same day, with breathtaking clumsiness, the government appealed against a pensions-tribunal decision to increase the compensation awarded to a pair of wounded soldiers.

One of the soldiers was shot in the leg in Iraq, and is now serving in Afghanistan. The other broke a leg on a training exercise. The Ministry of Defence (MoD) awarded them £9,250 ($15,144) and £8,250, respectively. But the soldiers argued that they had had further problems during treatment and judges raised the sums to £46,000 and £28,750 this year. The MoD maintains that only initial injuries should be eligible for compensation, and that the ruling jeopardises the principle that payment should be about injuries rather than disablement. A decision is expected in October.

The case has focused attention on the perceived injustices of the Armed Forces Compensation Scheme (AFCS), which pigeonholes injuries into 15 categories attracting compensation from £1,115 to £570,000. A formidable coalition of politicians, generals and veterans' associations has come together to criticise the government. The Royal British Legion, an armed-forces charity, points out that the AFCS was only meant to be a stopgap until the old War Pensions Scheme could be properly replaced. Medical advances mean that soldiers often come back with collections of wounds that would previously have been fatal, and do not fit easily into its categories.

Sir John Major, prime minister before Tony Blair, worries that the scheme is lopsided: soldiers can get over £500,000 for the worst physical injuries (losing both eyes and two arms, for example, or all four limbs) but the award for mental injury is capped at £48,000. Others say it is simply stingy: a favourite case is that of a civilian air-force typist, not covered by the AFCS, who was awarded £484,000 for repetitive-strain injury in 2007, whereas under the AFCS total blindness in both eyes is worth just £402,500. General Sir Mike Jackson, once head of the army, says diplomatically that the scheme is "not one of generosity".

This latest outbreak of unseemly penny-pinching is symptomatic of a governmental tin ear when it comes to the armed forces. Concern that the army is fighting two wars on a shoestring budget refuses to go away. The government spent much of July embroiled in an argument with generals (of both the real and armchair varieties) about whether troops have enough helicopters to ferry them around Afghanistan, beyond the reach of the roadside bombs that account for most British war deaths. Earlier this year the MoD was forced to allow Nepalese Gurkha mercenaries who have served in the British army to settle in Britain. On July 29th, aware that his department had again badly misjudged public opinion, Bob

Ainsworth, the defence secretary, rather lamely brought forward a planned review of the AFCS scheme from next year to this, though he made clear that it would not affect the cases now in court. Harbinger, perhaps, of a new battle plan.

Regulating estate agents

No code to break

Jul 30th 2009
From The Economist print edition

A sector crying out for more rules, and unlikely to get them

MOST people are all too familiar with estate-agent speak, in which "charming" means tiny and a "mature garden" is a jungle. The firms are only doing their job, which is to sell houses. Recession has made that tougher, and the temptation to indulge in hyperbole even greater.

This is harmless stuff, but estate agents who lie and cheat more seriously have enjoyed years of little or no regulation. It is only since October 2008 that they have had to become members of a redress scheme, so that complaints against them—for bigger sins than abuse of the English language—are handled in an orderly fashion. Such sins often involve taking secret commissions or failing to disclose hidden charges. Two schemes to resolve disputes exist, the bigger of which is run by the Property Ombudsman (TPO). Its ultimate sanction is reporting an estate agent to the Office of Fair Trading, which can put him on a register that bars him from practising. More than 130 are on the list.

Many in the property world argue that this is not enough, that it does not hold estate agents to a code of conduct. TPO tries to steer its members towards signing its own code, but there is no obligation to do so. There is not even a proper record of the number of estate agents in the country. By the end of June 6,904 firms representing 10,437 offices had registered with TPO. It reckons this is about 95% of the market.

An estate agent needs no professional qualification and the spectrum of practitioners is wide, from chartered surveyors, with letters after their name and their own tradition of integrity, to fly-by-night salesmen. It is the latter who have been worst hit by the downturn. The wiser fraternity, having seen housing blips before, kept something in reserve during the decade-long boom to 2008. Keith Johnson at JW Woods in Durham, for example, reduced his staff from 90 to 58 in the course of 12 months but closed none of his seven offices. A handful of smaller agents were forced to shut up shop around him.

Now, it seems, the worst may be over. Many sources are registering a small rise in house prices from May to June. The Land Registry, which logs actual sales, reported a 0.1% increase overall, with big regional differences. John Nicholas, an agent in Pembrokeshire, said his business was declining in June, whereas Roger Punch, at Stags in Plymouth, saw a "serious upturn". Interest in south-coast holiday homes has revived.

In a recovering but fragile market "who needs more red tape?", asks Grant Shapps, the Conservatives' shadow housing minister. Yet better regulation of estate agents and letting agents is on the government's agenda. Three hefty reviews—the Carsberg, the Jones and the Rugg—have thudded onto civil servants' desks in the past 14 months. The National Association of Citizens Advice Bureaux has produced a clutch of cautionary tales about letting agents' abuse of both tenants and landlords, including theft of rental payments and deposits. All conclude that the sector should be better regulated. The proposals range from mandatory but privately enforced codes to external policing.

Letting and managing agents are a particular problem because there is little record of births and deaths. Standards are in a muddle. "There's a feeling that this part of the industry has been running wild," says Julie Rugg at York University, who was responsible for one of the reviews.

A government consultation on the matter is in progress but has lost momentum. Little is likely to be done before the next general election, due by June. And then the reformers may have to reckon with Mr Shapps, who says he would scrap any attempt at "top-down regulation". He can live without more statistics, he says: "I don't know how many kettle manufacturers there are, and it doesn't bother me."

Mortgage lending

Baggage-handling

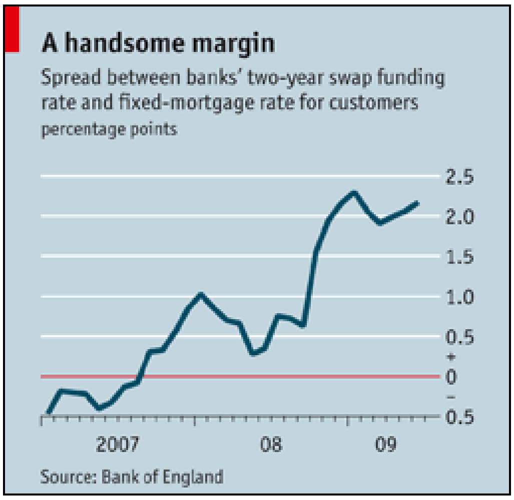
Jul 30th 2009
From The Economist print edition

Why only a few banks are offering good deals

IS THE housing market really coming back to life? Prices may finally have embarked on a tentative upswing but mortgage lending remains a mixed picture. Figures from the Bank of England on July 29th show that property loans increased in June by only £342m ($561m), about the same as in May and less than most economists were expecting. The number of mortgage approvals, however, rose by almost 8% to 47,600, up from a trough of 27,400 last November.

Mortgage lenders are fast dividing into two camps: those that are burdened with baggage and those that are not. The baggage consists of toxic assets (exposure to subprime mortgages and bad corporate loans, for example), obligations to increase capital to please the regulator and mortgages that were handed out too cheaply. It is the lenders' excuse for sitting on their hands rather than lending to firms and homebuyers.

The government has provided the Asset Protection Scheme to deal with the toxic assets. The Financial Services Authority is meant to be relaxing bank-capital rules in the downturn. And there are various government schemes to relieve pressures on less fortunate borrowers. But there is no cure for the mortgages that were mispriced in the boom times. These are the variable "tracker" loans that looked juicy when the Bank of England's base rate, which they track, was well above the banks' own cost of funds. By the time the base rate hit a low of 0.5% in March, however, the mortgages had long since ceased to make the banks money. Ray Boulger, at the mortgage broker John Charcol, says that his personal tracker mortgage is costing him a mere 0.19% above the base rate.



To make up for their past errors, many banks are now charging much higher margins on new lending. The margin on fixed-rate mortgages soared last December to over two percentage points above the banks' theoretical cost of funds, and has barely dipped since then (see chart).

That has left room for the banks with little or no baggage to enter the market or expand their presence at competitive prices. At the front of the pack is HSBC, with its online bank, First Direct. The pair are consistently near the top of comparison websites. Handelsbanken of Sweden, which has some 60 branches in Britain, is enjoying lending to the well-off. And the state-owned Bank of China is offering the best rates for buyers planning to let their property. With only five branches in Britain, it uses "mortgage packagers" who deliver clients with most of the paperwork done. As the bank insists on a face-to-face interview with every borrower and applies strict lending criteria this is hardly an assault on the mass market—yet.

Brighton's drug scene

High tide

Jul 30th 2009 | BRIGHTON
From The Economist print edition

The seaside town has a stubborn drug habit, and the police a new approach

Rex Features

A new prospect for drug addicts

DANDIES and partygoers have long flocked to Brighton, a sunny escape in the busy south-east. Its Royal Pavilion, a preposterous temple of fun completed by George IV, has modern equivalents in the form of a booming club scene, catering to hedonists from all over the region.

This wild side has a cost. Brighton recorded more drug-related deaths per head than anywhere else in Britain in the most recent two years for which data are available, according to a team at St George's, University of London. One reason is that its coroner keeps more meticulous records than others. Still, the problem is alarming , and shows no sign of improving. The latest suspected victim died last week, in the lavatory of a town-centre McDonald's.

How did Brighton acquire this seedy problem? Club drugs such as GBL, a new favourite with Brighton's big gay community, claim the odd victim. And an influx of outsiders at the weekend (up to a third of Brighton clubbers are out-of-towners) means that local death figures are inflated.

But Graham Stevens, who co-ordinates the city's drug and alcohol services, says the bulk of drug deaths are among people who live in the city. And the most deadly drugs—opiates such as heroin and, increasingly, illicitly-acquired methadone—are not clubbing drugs. An historical explanation may be more likely: Brighton was one of the first places to acquire a drug-dependency unit in the 1960s, perhaps establishing a reputation as a good place for addicts.

There may also be something about the English seaside: Bournemouth has a similar drug problem, and the second-worst place in Britain for drug deaths is Blackpool. The surplus of old hotels in these faded towns has created a large supply of bed-and-breakfasts, which double up as emergency social housing and homeless hostels. Homelessness has been especially acute in Brighton, where Londoners have forced up house prices.

Policing the use of drugs in these conditions had become a frustrating "merry-go-round" of conviction, release and reconviction, according to Detective Chief Inspector Paul Furnell, who has helped to launch a novel approach to drugs singled out for praise by the UK Drug Policy Commission, a think-tank. Rather than haul addicts and low-level dealers through the courts, Brighton's police now approach them informally, with drugs workers, and push them in the direction of rehab. If they refuse, they face arrest; most take the hint.

Prodding addicts into treatment without going to court has various benefits. Patients tend to respond better when rehab is voluntary (or at least semi-voluntary). And the old system was time-consuming—so much so that addicts would sometimes be taken to court just as they had got their act together and gone

into rehab themselves.

Best of all for the police, the fact that low-level junkies are handled by treatment services means that they themselves are free to pursue bigger fish. Plainclothes officers now covertly buy drugs almost daily, gathering intelligence for convictions. As junior dealers fall, suppliers drop down to fill the gap. One senior dealer recently had £80,000 of assets confiscated when he was forced to fill in on the street.

Measuring the impact of this new approach is difficult, but an independent study last year found that burglary, robbery and theft fell 18% in the scheme’s first two years, and calls to the police about open-air drug dealing slumped 70% in the first 18 months. The addicts referred to treatment had an average of 40 convictions each, so if rehab curbs their habit even slightly, large benefits will be seen.

The initiative has its risks. Shaking up networks brings new dealers into the market, often touting extra-pure product to attract custom. An unusually strong batch from a new gang coincided with a string of 18 heroin overdoses in the first four months of last year, which ended only when four men were arrested. Police say their covert buying helps them to know when a new batch comes in. And they hope that, by turning over dealers quickly, they will make it hard for them to colonise territory to fight over. It is this that has caused the epic violence in other cities which has not, so far, made it to Brighton.

The Liberal Democrat leader

The outrider

Jul 30th 2009
From The Economist print edition

Nick Clegg often leads the way, but not the polls

Guardian Syndication

Kingmaker-in-waiting Clegg

ICONOCLASM does not come easily to nice and privileged men: this seemed to be a lesson of Nick Clegg's early efforts as leader of the Liberal Democrats. Staged parliamentary walkouts and other attempts to distinguish himself from the Conservatives' David Cameron, the other well-scrubbed young leader on the opposition benches, were mocked as the work of a rookie trying too hard.

Mr Clegg's righteous ire should now be an asset. After all, voters share his disdain for the political class. The Lib Dems, an avowedly anti-establishment party, were not untainted by the recent parliamentary- expenses scandal but most of the mud stuck to the Labour Party and the Tories. While other parties answered the scandal with piffling proposals to revise parliamentary rules, says Mr Clegg, only the Lib Dems saw the link with Britain's deeper constitutional flaws, such as its winner-takes-all voting system (he notes that MPs with safe seats were more likely to be caught fiddling their claims).

Yet results have been mixed. A recent by-election in Norwich proved disappointing for the party, which only narrowly beat the fringe UK Independence Party into third place. It was the Tory candidate who prospered from the collapsed Labour vote. Neither were the European Parliament elections in June a triumph. But the party fared better in the local elections held the same day, and its poll rating has risen in recent months, to around 20%. In May it threatened to overtake Labour.

But wondering why the Lib Dems are not doing better is a recurrent pastime in Westminster (including during the worst of the credit crunch, when the wise words of Vince Cable, their treasury spokesman, did not translate into poll gains for the party). Support for the Lib Dems is linked only loosely to rational factors such as their own proposals, the issue of the day (though the unpopularity of the Iraq war helped the party, which had opposed it, do well at the last general election) and even the fortunes of the two main parties. It may be that voters pay so little attention to the Liberal Democrats that their support will almost always float between 15% and 20% of the vote, regardless of events.

Mr Clegg influences politics in two ways that depend little on his party's electoral showing, however. If the next election yields a hung parliament, the Lib Dems may enter government in coalition with either of the big parties. Even if they lose MPs (and many of their southern ones are vulnerable to the Tories), they need only hang on to third place for Mr Clegg to remain kingmaker-in-waiting. This consideration doubtless plays a part in the government's hints that it is pondering a referendum on a "fairer" voting system. The Lib Dems crave full-blown proportional representation but may decide the best chance of any reform lies with Labour.

Mr Clegg can also shift the political debate in his direction. His campaign on behalf of veteran Gurkhas, the Nepalese soldiers who serve Britain, forced a government u-turn in April. The decision of some Lib Dems to monitor police conduct during the G20 protests was seen as pretentious by many, but it was vindicated by events. Mr Clegg was also the first party leader to call for the resignation of Michael Martin, the former speaker of the House of Commons, who duly stood down in June. His outrider status may prove as influential on matters of tax and spend. He has named government schemes he wants scrapped (baby bonds) or shrunk (the nuclear deterrent). The fiscal crisis may yet force the two big parties to be as specific.

Paying for the monarchy

Buck's fizz for the masses

Jul 30th 2009
From The Economist print edition

Why an open-door policy makes sense

AP

In better shape than their setting

TOURISTS jostled at the ambassadors' entrance to Buckingham Palace this week, eager, even at £16.50 a head, to see the gilded state rooms opened to the public on July 26th for the summer. This is now an annual event, raising money to catalogue and restore the royal art collection and to maintain the palace itself.

It is not raising enough, it seems. The dresses on display from the queen's official visits abroad are glamorous but their setting is tarnished. Scaffolding covers crumbling stonework; in 2007 falling masonry narrowly missed Princess Anne's car. The boomerangs, totem poles and other gifts lavished on the queen during her tours distract only briefly from the 60-year-old electrical system. The palace needs complete re-wiring, re-plumbing, refurbishment and re-roofing, according to the keeper of the privy purse, Sir Alan Reid. And this is only part of a backlog at all four state residences that could run to £32m. Some buildings are worse off than Buckingham Palace. The Royal Mausoleum at Frogmore, where Queen Victoria and Prince Albert are buried, is so dilapidated that English Heritage, a preservation outfit, has it on its register of buildings at risk.

Who will foot the repair bill? The queen does not own these buildings personally, as she does Balmoral in Scotland, for example; they are where she carries out state business and part of the country's heritage. The government pays for the upkeep of many national monuments, such as Stonehenge. In contrast, the Church of England bears the brunt of maintaining the likes of St Paul's Cathedral (which charges adults £11 per visit). Where do palaces fit in?

The royal household has asked that the £15m annual grant for palace maintenance be increased by £4m, but the government has said no. Politicians are not keen to see a big rise in the cost of the monarchy, especially in these straitened times. They suggest opening Buckingham Palace for longer than the 60-odd days a year that its doors now stand wide, and using more of the money to fix its fabric.

Royal bean-counters reckon the cost might outweigh the likely income. Some point out that there is money in the exchequer that could be used: the taxpayer is not subsidising the monarchy but making a tidy profit from it. The queen, like her predecessors, gave up the Crown Estates' income on her accession in return for money to run the royal show. Over the past ten years alone, the Treasury has received £1.3 billion more under this deal than it has paid out (see chart).

The best reason for opening the palace more often is simply to give the public, both domestic and foreign, better access to it. Overseas tourists commented this week that as a "living museum" it added hugely to Britain's attraction as a destination (thus boosting the revenue of hotels, restaurants, public transport and indeed the taxman). And opening her house to her subjects binds the monarch to her people. In the 1700s Queen Caroline, the wife of George II, asked Sir Robert Walpole what the cost would be of limiting public access to a royal park. His answer was "only three crowns"—those of England, Scotland and Ireland. Food for thought today.

The centre-left

The challenge of turning malcontents into (sensible) militants

Jul 30th 2009 | SKIATHOS, GREECE
From The Economist print edition

In most of Europe moderate leftists are having a bad recession—but things look more promising for them elsewhere

Reuters

WHEN George Papandreou, the Greek opposition leader and president of the Socialist International—a global association of centre-left parties—convened the latest of his summer talkfests on the shores of the Aegean, the mood was upbeat. Veterans of the annual gathering said it was the cheeriest they could recall.

But the reasons for the optimism blowing in the pine-scented air were mainly local: after struggling for several years to rally discontent with Greece's ruling conservatives, Mr Papandreou is now doing well in the opinion polls. He has a good chance, some time over the next year, of becoming prime minister, following in the trail of his liberal grandfather and firebrand father.

Ségolène Royal, the French vice-president of the Socialist International (SI), also came to the Aegean with a success story of sorts, but it too was on a small scale. In the region of Poitou-Charentes, which she runs, the problem of voter apathy is being solved, she insisted, with newfangled experiments in grassroots democracy: for example, "citizens' juries" chosen by lot to monitor the work of local officials.

If the talk turned to town-hall matters, that was partly because, nationally, this is a bad moment for Ms Royal, whose party is in chaos. The picture is hardly more cheerful for much of Europe's moderate left, whether in power or in opposition. With the exception of Greece, the European elections in June were a disaster for social democratic parties. From France to Austria, centre-leftists failed to harness dislike of conservative incumbents. There was a swing against ruling socialists from Bulgaria (where they were ousted from national power in July) to Britain (whose prime minister, Gordon Brown, looks irredeemably unpopular). In Spain supporters of the ruling socialists tried hard to convince people that they were as upset as anybody about unemployment of nearly 20%, but voters still nudged to the right.

Elsewhere in the world, the picture is more mixed. But in almost every democracy, politicians who style themselves progressive face a common set of problems, to do with shrinking treasuries, looming environmental challenges, general pessimism and the resurgence of nationalism.

There is a paradox here. In many ways, the centre-left should be making hay. Whatever problems he may face at home, Barack Obama has emboldened critics of the status quo—and made life harder for purist conservatives—across the world. Mr Obama has given heart to those who argue that democracy (as opposed to street protests or violence) can produce real change; and helped those on the left who still say that America, for all its recent flaws, can be a guarantor of democracy and freedom.

Meanwhile the banking crisis and the global downturn have been seized on by the Cassandras (many of

them worthy centre-leftists) who said, even at the height of the boom, that global capitalism might become an uncontrollable monster.

But many voters seem unconvinced by the efforts of the centre-left to cash in with told-you-so talk. In some cases, that is because the right has stolen their clothes by launching economic rescue packages, and joining the denunciation of wild "Anglo-Saxon" capitalism. France's conservative president, Nicolas Sarkozy, for one, has borrowed personnel as well as rhetoric and ideas from the left.

In several countries the centre-right has held together with a judicious mixture of talk about tough border controls and promises of economic regeneration. "They sound just a little bit harder on immigration and voters get the hint," says Charles Grant of the Centre for European Reform, a think-tank. The centre-left, by contrast, has haemorrhaged votes, as malcontents drift to various extremes, or into apathy.

A Marxist moment

Indeed, if any group has been making told-you-so arguments with success, it is the radical foes of the system, including Marxists, who denounce their more cautious comrades for being complicit in the capitalist order. In Germany, for example, the far-left vote held up better than that of parties nearer the middle—though some thought it would do better still.

AFP

In the pink: Papandreou and Royal

Admittedly, some of the travails of the European centre-left reflect problems that are peculiar to the old continent. Under parties of any stripe, Europe's relative weight in the world economy would be doomed to decline—along with its ability to fund welfare programmes whose roots go back to post-1945 reconstruction and the ideological contests of the cold war.

Australia's Kevin Rudd, whose Labor Party scored a landslide victory in 2007, is holding up in the opinion polls, despite the difficulty of keeping promises and transforming the country's environmental posture in a deep recession. But Mr Rudd has advantages that his European counterparts lack: the cushion provided by a decade-long boom, and by signs that China—which buys Australia's commodities—is rapidly emerging from the downturn. He is promising a return to fiscal caution once his stimulus has helped the economy.

In Latin America, meanwhile, the centre-left is riding out the recession with comparative success. Take Brazil's President Luiz Inácio Lula da Silva, whose working-class origins and pragmatic policies are still a winning mixture. He has managed to convince his compatriots that the recession was thrust upon the region from outside: it is, as he puts it, the fault of "blonde, blue-eyed" bankers from the north.

And in Latin America the centre-left has reaped some benefit from stimulus packages designed to protect jobs. In Chile—homeland of the Socialist International's secretary-general, Luis Ayala—such measures have boosted the popularity of the ruling coalition, three of whose constituents are members of the SI. The centre-left is now tipped to win a forthcoming presidential election, mainly because voters feel the need to protect the poor. For similar reasons, Uruguay's ruling left-of-centre coalition looks set to retain power in an electoral contest this autumn. And in Mexico's recent legislative election, it was the

Institutional Revolutionary Party, a lumbering titan of the centre-left, that gained at the expense of the ruling conservatives, not parties of a more radical stripe.

At the same time, Latin America's far left seems a less attractive option for people hard hit by recession. More than in Western Europe, voters there have experience of far-leftist experiments—and their results. Administrations of a deep-red hue are now in power in a few countries, and their economies are in some ways doing worse than those of their neighbours. The red-hot "21st-century socialism" of Venezuela's President Hugo Chávez has been obliged to cool down by sagging world energy prices. In Argentina's mid-term election, in June, the populist government of President Cristina Fernández de Kirchner lost its parliamentary majority.

True, there is one country where a centre-leftist leader is struggling under the impact of the recession, and under threat from radicals—Peru. But even there, ultra-leftism is not in the ascendant: the main radical contender for the 2011 election, Ollanta Humala, has tried to portray himself as a moderate and stressed his differences with the fiery Mr Chávez.

Is green the new colour?

Both in the commodity-rich economies of the South, and in the tired old industrial societies of the North, a common dilemma—and perhaps, opportunity—for moderate leftists is posed by the environment.

Especially in Europe, centre-leftist politics and concern for the planet have almost blended into a single, warm and sometimes fuzzy discourse. Mr Papandreou, for one, expects a full merger. He wants to add environmentalism to the SI's core ideals of democracy and social justice. At home, he has taken risks in defence of that idea, by recruiting to his party a young independent green, Kriton Arsenis, whose campaign against construction on Aegean islands had threatened vested interests, including pro-Socialist ones.

But elsewhere, the terms of a political marriage between social democracy and greenery look uncertain. Many eyes are on Germany, where the Social Democratic Party (SPD)—now sharing power with the centre-right—did appallingly in the Euro-elections, with a record low of 21%, even as the Green vote held steady at 12%.

What does this portend for Germany's general election on September 27th? On the face of things, the only possibility of a left-of-centre government lies in a new "red-green" coalition, like the one that held power from 1998 to 2005, but with the greens dictating more of the terms.

A Green legislator, Kerstin Andreae, says the SPD is paying the price for internal strife and a lack of convincing leadership. The centre-left is still seen as the tree-huggers' natural partner. Recent German polls have sent a different message, however: that some voters like the idea of a more improbable alliance of greens and centre-rightists, a so-called black-green alliance of the kind that now has power in Hamburg.

Could it happen nationally? Ms Andreae notes that there are big gaps between her party and Germany's Christian Democrats (over nuclear power, say)—but she concedes that they have moved nearer the centre and "we have hopes for them." The only thing her party has ruled out is a "Jamaica" (green-black-yellow) deal with Christian Democrats and the liberal Free Democrats, in which the Greens would represent a lone non-establishment voice.

If Europe's premier green party made a deal with the centre-right, that might leave the centre-left feeling lonelier than ever. But recent events in Ireland (where centre-rightists and environmentalists have been sharing power) contain some sobering lessons for anybody contemplating such a bargain. In the European elections, both parts of the ruling coalition were soundly thrashed by recession-weary voters, especially the Greens.

Still, even in Ireland, centre-leftists would be wrong to see the environmentalists as tame fellow-travellers, easy to co-opt because they have nowhere else to go. Whichever partners they choose, green-minded people will have their own ideas.

Take Nessa Childers, an Irish Labour Euro-MP who was formerly a local Green politician. She, at least, is not about to convert to dogmatic leftism. "The old left-right divide has ceased to reflect the choices

people have in their lives," she says. Instead, she hopes her new colleagues will wrestle harder with the meaning of "sustainable policies—for the fabric of society as well as for the planet." Another good topic for a summer symposium.

Shipping in the downturn

Sea of troubles

Jul 30th 2009
From The Economist print edition

The recession is buffeting the world of shipping—with even rougher waters ahead

AFP

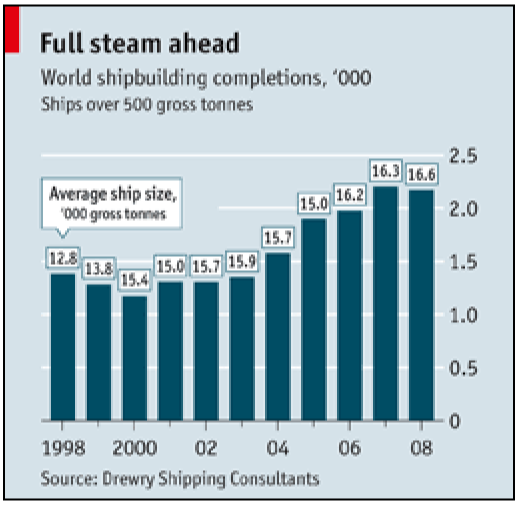
FROM the sheltered waters of Subic Bay in the Philippines to Falmouth on the south coast of England, a vast, swelling armada lies idle. In Asia's deep-sea havens 750 vessels—container ships, bulk carriers, tankers, car carriers and others—are laid up. A further 280 are sheltering in European waters. According to Lloyd's Marine Intelligence Unit, nearly 10% of the world's merchant ships are swaying gently at anchor because of a collapse in global trade.

Since the recession bit hard last autumn a lot of attention has been paid to the plunge in the Baltic Dry Index, a composite measure of the cost of shipping bulk cargoes such as iron ore and coal. It fell by over 90% between June and October last year, although it has since recovered slightly and is hovering at just above a quarter of its peak. World trade in general remains in its worst slump for generations, although it too is no longer falling. Two of the biggest shipping banks (RBS and HBOS) are in state-backed rehab. The parlous state of the world economy could mean more shipping companies following Eastwind Maritime, which went bankrupt in June. On July 28th Hapag-Lloyd, Germany's largest container-shipping company, secured a €330m ($468m) bail-out from its shareholders while it seeks up to €1.75 billion to keep it from sinking altogether.

Worse, there is a huge supply of new ships on order and due off the slipways over the next four years. For bulk carriers alone, the backlog is equivalent to more than two-thirds of existing capacity. Philippe Louis-Dreyfus, departing president of the European Community Shipowners' Associations, has called for an industrywide scrappage scheme to shrink the surplus. Warning of a "bloodbath", he said in June that shipping capacity would exceed the needs of the market by between 50% and 70% in the near future.

Nothing like this has been seen since the early 1970s, when lots of super-sized oil tankers, known as VLCCs (very large crude carriers), were built in expectation of huge growth in oil consumption just before the first oil shock. The result was a persistent surplus and no more orders for VLCCs for a decade. By the late 1990s the number of ships completed was running at around 1,300 a year. But from 2004 production picked up. Ships have also been getting larger (see chart). By last year annual completions were up by nearly 60% compared with a decade ago and the ships were 30% bigger. No wonder *Lloyd's List*, an industry journal, is full of news of ship seizures and bankruptcies.

Yet a ray of sunshine is breaking through the storm clouds. The world's shipbuilders are unlikely to convert all of their huge backlog of orders into deliveries given their unrealistic workloads



and likely cancellations. Drewry Shipping Consultants estimates that nearly half the ships due to be delivered last year are still sitting on the slipway or the drawing board. Analysts at ICAP Shipping Research in London shrug off the idea that there will be a glut, since shipments of cheap Australian coal and iron ore to China have for years been constrained by a lack of big ships. More giant bulk carriers will lower the prices of ores delivered to China and stimulate trade growth, they say.

The outlook for tankers is less clear because of the volatility of crude-oil prices. Rates recovered strongly in June, according to ICAP, partly because large vessels were in demand for storage, as oil companies waited for crude prices to strengthen. Looking further ahead, the International Energy Agency expects oil demand to fall by 2.5m barrels a day this year, having already dropped by 300,000 b/d in 2008. But lower demand will be offset by a scheme to phase out single-hull ships on environmental and safety grounds in European and North Atlantic waters. The decline in production from mature oilfields in the North Sea and Alaska also means that replacement supplies will have to be hauled longer distances by sea to the refineries of Europe and North America.

The part of the shipping industry headed for the choppiest waters is the container trade, which had steamed ahead gloriously since the mid-1970s. The forging of global supply chains in the past 20 years, the rise in merchandise trade and the emergence of China as the workshop of the world created growing demand. Vessels became gigantic, with the latest capable of carrying 15,000 standard containers. Now the box trade, as it is called, is in the midst of its first decline. AXS Alphaliner, an information service that tracks the trade, has estimated that some 15% of capacity will be idle by October.

Shipping companies that operate the main container services linking Asia, America and Europe will lose about $20 billion this year, after making only $5 billion profit in 2008, according to Drewry. To blame is a $55 billion fall in expected revenues, only partly offset by savings from lay-ups, "slow steaming" to conserve fuel and opting for the longer and cheaper route round the Cape of Good Hope, which avoids hefty fees for using the Suez Canal. The canal faces a drop in revenue of 14% this year. Container rates have tumbled: before last summer it cost $1,400 to move a container from China to Europe; today the rate is barely $400. Chang Yung Fa, the boss of Evergreen group, the world's fourth-largest container fleet, based in Taiwan, talks of a "gruesome" excess of capacity. Three years ago he dropped plans to order new ships. Now he is scrapping part of his 176-strong fleet.

The grim outlook for container shipping is not simply a reflection of the recession. There is a deeper concern. Containerisation helped to promote globalisation by reducing the cost of shipping goods so sharply that manufacturers could afford to search the world for factories where costs were lowest. As a result, the amount of sea transport involved in manufacturing a given product rose. But some analysts worry that this one-off restructuring may be almost complete. So even when the world economy recovers, the rapid expansion of container trade may not resume.

The Chinese car industry

The ambition of Geely

Jul 30th 2009 | HANGZHOU
From The Economist print edition

A Chinese carmaker shrugs off the global downturn

Bloomberg

Another show, another concept

AT A time when most carmakers are struggling to cope with the worst crisis the industry has experienced in living memory, the ambitions of Geely, China's biggest privately owned car firm, are breathtaking. The company is simultaneously developing six modern platforms—an astonishing number even for a global giant such as Toyota—and is committed to launching nine new cars in the next 18 months and up to 42 new models by 2015. Its technical director, Frank Zhao, claims that Geely will have the capacity to make 2m cars a year by then.

Whether Geely will be able to sell anything like that number of cars is another matter. The firm says its sales for the six months to the end of June reached 138,000, fuelled partly by government tax breaks aimed at boosting demand for the smaller cars made by China's indigenous manufacturers. That implies a rise from a year ago of no less than 52%, nearly three times the rate at which the China Association of Automobile Manufacturers (CAAM) estimates the market grew in the same period. But the numbers are confusing: J.D. Power Asia, an automotive market-research firm, reckons Geely sold more cars than that, but from a higher base, leaving its growth slightly below that of the market as a whole. Geely itself uses different figures in different statements.

At the Shanghai motor show in April, no exhibitor had a bigger stand. On display were three new sub-brands—Gleagle (affordable saloons and small utility vehicles), Emgrand (sporty and prestige vehicles) and Shanghai Englon ("heritage" designs)—embracing more than 20 models and their variants, including six that were all new. Among them were the outrageous Shanghai Englon GE concept, a mini-me of the Rolls-Royce Phantom with a single throne-like seat in the back; the Emgrand EX825, a blingy SUV scheduled for launch next year; and the Gleagle EK2, a small battery-powered hatchback that is said to be close to production. Also on the stand was Geely's version of the London black cab, the product of a joint venture with Manganese Bronze Holdings, the British company that owns London Taxi International.

Geely appears to have no difficulty funding its expansion. Under Mr Zhao, a former Chrysler executive recruited in 2006, Geely has not only increased the number of engineers it employs from 350 to 1,200, but has established an entire university, the Zhejiang Automotive Engineering Institute, to turn out lots more. It has also bought assets abroad.

Yet there is a lurking suspicion that Geely's cars are not developed to the same the standards as Western ones. Geely's chairman and founder, Li Shufu, the self-styled Henry Ford of China, has frequently boasted that his firm would quickly become an export champion, selling 1.3m cars abroad by 2015. To that end, in 2005, the year after its initial public offering in Hong Kong, Geely exhibited its entire range of cars at the Frankfurt motor show, followed up with an appearance at the Detroit show in 2006. Mr Li

talked about entering the European market in 2007 and breaking into North America by 2008, but even now those remain fairly distant goals.

Mr Li's world-conquering plans were badly dented when a Russian car magazine crash-tested a Geely CK small saloon at 64kph (40mph). Both driver and passenger were given a survival chance of only 10%. Geely sold about 30,000 units outside China last year and assembles cars from kits in Russia, Ukraine and Indonesia. It also plans to build factories in South Africa and Mexico. Mr Zhao thinks Geely's cars can now pass the strict emissions and safety standards of the rich world. The problem, he argues, is more to do with reputation than the firm's latest products.

There are also persistent rumours that Geely is negotiating to buy a European car company. A few weeks ago, Geely was said to be casting an eye over GM's Swedish unit, Saab, but nothing came of it. Now, Geely is supposed to be preparing to buy Volvo, a much bigger outfit than Saab, from Ford. But Ford would be a very wary seller, fearing that Geely might run off with too much valuable intellectual property. It is, after all, a carmaker in a hurry.

A deal between Microsoft and Yahoo!

Bingoo!

Jul 30th 2009 | SAN FRANCISCO
From The Economist print edition

The world's biggest software firm and web portal team up to challenge Google

USERS will probably not notice the difference. But the deal between Microsoft and Yahoo!, the world's biggest software firm and the leading web portal, for a ten-year partnership in searches and advertising on the internet, may one day be seen as a momentous event. The combination, which was announced on July 29th after years of speculation about a tie-up, is not as far-reaching as originally envisaged. But it is likely to create a serious rival to Google, the online giant that dominates both of these activities.

The agreement is supposed to help both parties overcome their most pressing problems. Microsoft will significantly increase the use of its search service, called Bing, and its platform to place online advertisements, because Yahoo! will use both of them on its websites. The web portal, for its part, will be able to cut costs and increase revenues. Yahoo! will no longer have to invest millions in its search and advertising technology, both of which it will hand over to Microsoft. It will also get more money for the ads placed next to its search results. Carol Bartz, Yahoo!'s chief executive, said that the tie-up "comes with boatloads of value" for her firm. During the first five years of the deal, it will receive 88% of the revenue generated by ads next to search results on its web page.

The deal is the result of a long mating dance which started in February last year when Microsoft made a $44.6 billion takeover bid for Yahoo!, later raising its offer to $47.5 billion. But Yahoo!'s bosses rebuffed Microsoft, saying the offer undervalued their firm. Instead Yahoo! made an agreement with Google on advertising, only to see it scuppered by concerns that antitrust objections could lead to protracted legal wrangling. Talks between Microsoft and Yahoo! were rekindled after Ms Bartz took the helm at Yahoo! in January. She is less emotionally attached to maintaining its independence than her predecessor, Jerry Yang, one of the company's founders.

Despite Ms Bartz's cheerleading, investors were disappointed. Yahoo!'s share price fell by 12% after the announcement. The firm is said to have pushed for an upfront payment of billions of dollars, but has not received one. What is more, the deal covers only text ads displayed alongside search results and not other forms of online advertising. On the plus side, Yahoo! will sell higher-priced search ads for both firms, allowing it to maintain relationships with advertisers.

The combination may in time be able to threaten Google's dominance in web search. The deal will mean that Microsoft handles nearly 30% of searches in America, compared with Google's 65%. As it is, Bing is gaining ground, and Microsoft will now have more data with which to improve it. Even more important will be the challenge to Google's lucrative business in search-related ads, a market which it dominates even more with a share of over 70% in America.

Earlier this month, Google announced that it is developing a free operating system for personal computers called Chrome OS, thus mounting a direct attack on Microsoft and Windows. With the Yahoo! deal, Microsoft is now pushing into Google's heartland. The battle lines between the technology titans are becoming ever clearer.

Spotify v illegal downloads

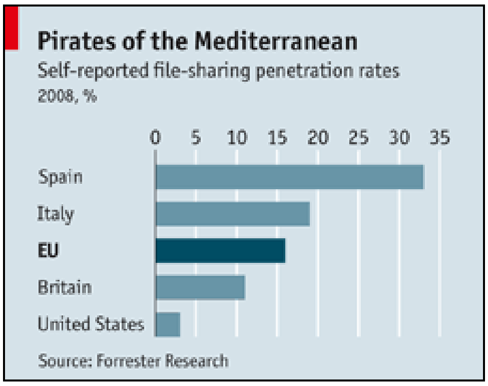
Free but legal

Jul 30th 2009
From The Economist print edition

Advertising-supported music will not save a troubled industry. But it helps

CAN legal free music compete with the illegal stuff? It seems so. Firms such as Spotify, founded by Swedish programmers, and we7, based in Britain, stream music on demand to European computers in return for nothing more burdensome than the odd advertisement. Together they have quickly amassed 8m users. On March 24th Spotify asked Apple to authorise an application for the iPhone that would take music-streaming mobile.

It is a bright spot in the music industry's long, perilous journey to the digital world. Worldwide sales of music in the form of CDs and DVDs fell by 15% last year, according to the International Federation of the Phonographic Industry (IFPI). Digital revenues, though rising, are not making up the shortfall. Most worrying is the rise of a generation used to obtaining music illegally through file-sharing, particularly in Europe (see chart). Lawsuits and crackdowns have displaced file-sharing from public networks into more secretive ones and into things like e-mail, from which it will be virtually impossible to root out.



Which is why outfits like Spotify and we7 are so important. If 95% of music downloads are illegal, as the IFPI believes, there is a huge potential market for legitimate music. Free streaming appears to be tapping it. Rob Wells of Universal Music reckons that 60-70% of Spotify users have resorted to file-sharing in the past. It is doubtful that all of them have been weaned from piracy: after all, pirated music has the immense advantage that it can be saved and transferred from one device to another. But it is a start.

Gartner, a research firm that has polled file-sharers, finds that Britons and Americans mostly resort to illegal sources not because they want to stick it to the music companies but simply because the websites are free and have a good selection of tunes. (By contrast, illegality is part of the appeal in Italy.) Ad-supported streaming competes well on both counts. Although there is still more music available for illegal downloading than for streaming, the lawful websites are at least free of viruses, and of decoy files put there by the music firms.

But it is not clear that streaming services can generate profits. "Nobody is making money from the ad-funded models," says Steve Purdham, the head of we7. The rise of music-streaming websites in the past year has coincided with a sharp drop in spending on advertising in general. Although royalty rates have come down they are a hefty burden on companies that have attracted customers at such a rate. They are burning venture capital.

At present a little more than 40,000 Spotify users pay a monthly subscription to obtain better sound quality and avoid advertisements—a puny number compared with the 6m who have installed the free application. The company sorely needs to raise the proportion of premium subscribers. Hence its mobile ambitions. The new iPhone application, which allows users to store songs temporarily, would be available only to paying customers. Being mobile, it would negate one of piracy's big advantages (although its cost would reinforce another one). As Mark Mulligan of Forrester, another market-research firm, points out, it also looks disturbingly like an alternative to Apple's popular iTunes online music store. That may persuade Apple to reject it.

Free streaming will not save the music business. But neither will anything else in isolation. As Paul Brown of Spotify puts it, the health of music depends on moving from one source of revenue—CDs—to perhaps a dozen. If the streaming websites can work out how to draw paying subscribers and lure more advertising, they may well become one of those sources.

Wind power in America

Becalmed

Jul 30th 2009 | NEW YORK
From The Economist print edition

After a record year, America's wind industry is suffering growing pains

Alamy

Twirl, interrupted

ON THE back of $16 billion-worth of investment, America overtook Germany to become the world's biggest wind-power generator last year. Wind accounted for 42% of new generating capacity, up from just 2% four years earlier. America's blustery and lightly populated heartland states are ideal sites for turbines, so the country's wind industry seemed poised for big things.

But this year momentum has slowed. An indication of the way the wind is blowing came in July when T. Boone Pickens, an oilman turned clean-energy entrepreneur, decided to call off plans for the world's biggest wind farm, in Texas. His 687 giant turbines, ordered at a cost of $2 billion, are now looking for new homes.

Mr Pickens could not arrange for transmission lines to be built from his wind farm to areas where the electricity is needed. Because they dominate the landscape, big wind projects work best in places few people live. America's "wind belt" runs from Texas up to the Dakotas. Texas and North Dakota have both been called the "Saudi Arabia of wind". But unlike oil, wind cannot be put in a tanker and shipped. It requires expensive grid infrastructure, which in turn rests on a complex and time-consuming approval process.

The industry is hopeful that new legislation will give the Federal Energy Regulation Commission powers to speed things up (state authorities hold most sway and rules differ from place to place). But that is not the industry's only difficulty. The credit crunch has finally caught up with it.

Wind is a capital-intensive, heavy manufacturing industry with long lead times, which is why despite everything 2008 was a record year and many installations have gone ahead in 2009. However, a big slowdown is expected soon as customers who have made downpayments on new turbines fail to get the financing needed to complete their orders.

Last year generating capacity surged by 50%. This year the American Wind Energy Association (AWEA) forecasts growth of only 20%. The AWEA says that although 2,800MW of new capacity was installed in the first quarter, just 1,200MW went in during the second.

But everything is relative. The AWEA's Liz Salerno notes that 2009 is still on track to be the industry's second-best year ever. She adds that wind is contributing not only generating capacity, but also much-needed manufacturing jobs. Nordex, a German company that is one of the world's biggest turbine manufacturers, recently announced a new factory in Arkansas, creating 700 jobs in an economy that is shedding them by the hundreds of thousands. GE reported dismal results for its second quarter, but GE Energy, which includes the conglomerate's wind business, was a bright spot, with profits up by 13% to

$1.8 billion. It is establishing a new research facility in Michigan, where the unemployment rate is 15%. Including GE, seven of the world's ten biggest wind-turbine-makers have factories in America.

The Obama administration is also firmly behind the industry. On July 16th Steve Chu, the secretary of energy, announced $14m for wind research. February's fiscal stimulus bill also provides money for new projects on the ground. Until this year, the main spur to private finance was tax credits. But when the banks crashed, they could not claim the credit, as they had no profits to claim it against. The stimulus package allows firms to convert the tax break into upfront payments. Rules for applying were clarified in early July and from next month firms can put in their bids.

The biggest boost to wind, however, would be a federal bill requiring power companies to get a fixed proportion of their electricity from renewable sources along the lines already established by 33 states. The House of Representatives has passed a bill aiming to cap carbon emissions, which includes an obligation to buy renewables, but the AWEA (unsurprisingly) thinks it too modest. The bill now goes to the Senate, though passage is far from guaranteed. Even if it does not pass in its entirety, some form of obligation remains a possibility. Wind still accounts for just under 2% of America's electricity. Despite the lull, that proportion seems certain to keep growing.

The recession in advertising

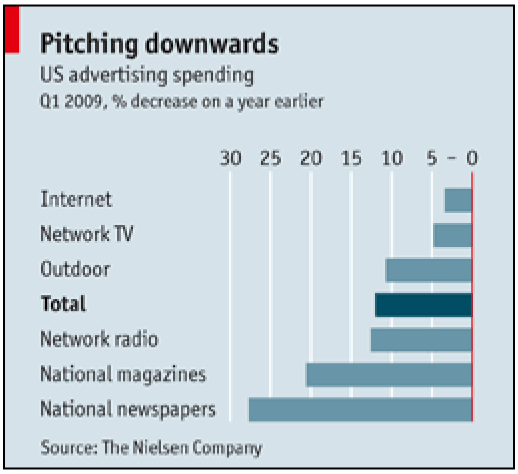
Nothing to shout about

Jul 30th 2009 | NEW YORK
From The Economist print edition

Things are still getting worse for the advertising industry

“WE LED into the downturn, we’ll lag the upturn. Overall, it’s very tough,” says Sir Martin Sorrell, boss of WPP, a big advertising group. Advertising budgets tend to be one of the first things cut when times get difficult, he sighs, though it often costs firms more in the long run to recover the resulting lost ground. WPP had expected a hard 2009, budgeting for a 2% decline in revenues. But that now looks wildly optimistic, after a 5.8% year-on-year decline in the first quarter, and an even worse April and May.

These are global numbers, buoyed in part by WPP’s strong presence in emerging markets such as China, which have weathered the economic crisis better than most. In America, things are worse. Total ad spending fell by more than 10% in the first quarter (see chart) and predictions for the full year are even more dire. Spending on advertising will fall by a “normalised” 14.5% this year in America, from \$189 billion to \$161 billion, according to the latest forecast by Magna, a research arm of Interpublic Group, another big advertising company. The actual decline is even bigger, which is why Magna has adjusted the numbers to reflect the lack of big quadrennial spending events, such as last year’s Olympic games and American elections. The outlook is so bleak that some ad agencies have resorted to outlandish tactics to raise revenues (see article).



For many businesses that carry ads the pain is even greater still. Advertising in magazines is expected to fall by 18.3%. Radio advertising is predicted to plunge by 21.8% and newspaper advertising by 26.5%, which is why so many papers are struggling to survive. Even the much hyped rise of online advertising has been reversed, with spending forecast to decline by 2.2% in America this year.

Next year Magna projects a further decline in total spending of 2.1%—or of only 0.4% if spending related to the winter Olympics and America’s mid-term elections is added to the mix. But even this scenario depends heavily on a return to economic growth, says Magna’s Brian Wieser, who prepared the forecast. Unlike WPP’s Sir Martin, Mr Wieser believes that advertising spending moves in line with economic growth, rather than lagging behind it as the economy recovers.

Others in the advertising industry fear that when the economy does eventually pick up, the old link between GDP and ad spending will prove to have been broken, because the cyclical downturn will have accelerated several structural trends that were already hurting conventional advertising. One is that clients are becoming far more demanding. They increasingly want evidence that their expenditure is worthwhile. In April Coca-Cola said it was adopting a system of “value-based compensation” for the advertisers that work on its 400 or so brands, rather than paying them for time spent. This would cover the ad agencies’ costs, with a “performance” bonus of up to 30%. Procter & Gamble had earlier announced a similar scheme for 12 of its brands. If this catches on, it will spell the end of the billable hour.

At the annual gathering of the advertising industry in Cannes at the end of June, all the talk was of the accelerating shift away from established forms of advertising, especially the 30-second commercial, towards newfangled social media. The winner of the coveted Titanium prize was Barack Obama’s election campaign, which was a combination of “lousy advertising, but great marketing,” says Marian Salzman of Porter Novelli, a unit of Omnicom, another huge advertising group. This inspired much debate about how to turn every customer into an evangelist, and how to drive grassroots campaigns using Facebook and Twitter. A forthcoming book by Mr Obama’s chief campaign strategist, David Plouffe, seems destined to become the ad industry’s new bible.

Not everyone is convinced that a revolution is under way. John Deighton of Harvard Business School claims that social media were crucial to the Obama campaign only in the first half of the primaries, because using them is well suited to "insurgency". After that, he says, the campaign reverted to a fairly standard effort dominated by television advertising. Indeed, Mr Deighton believes that the television commercial will remain the mainstay of the advertising industry for years to come. Magna's Mr Wieser seems to agree, noting that, contrary to reports of its demise, America's viewing habit continues to grow, and ad spending on national campaigns is likely to fall this year by only 6.3%—a triumph, in the circumstances.

Local television advertising in America has been hit much harder, owing to the car industry's woes, especially the bankruptcies of Chrysler and General Motors. Car dealerships, which are closing in large numbers, are big advertisers. But Benjamin Swinburne, a media analyst at Morgan Stanley, is forecasting a surprisingly strong rebound in advertising, especially on television, because dealers' spending on car and truck ads has fallen implausibly low: down by 65% in the first quarter of 2009 compared with the same period last year.

Perhaps the sharpest divide in the advertising industry is between those who think that as the economy revives consumers will rediscover their old spending habits and those who disagree, such as Ms Salzman of Porter Novelli. She says that American consumers "have changed in the same way there were Depression Babies who as adults would drive a car into the ground before replacing it." Fast-food restaurants have been one of the few sources of higher ad spending this year, as they tap into newly value-conscious consumers, says Annie Touliatos of Nielsen, a media research firm.

Sir Martin, too, thinks that American and European consumers have been "scarred", and will take a long time to rediscover the joy of splashing cash around. But as Mr Swinburne points out, advertising has done so badly of late that "it doesn't have to come back all the way to have a strong recovery".

Advertising firms seek sidelines

Stretching the accordion

Jul 30th 2009 | NEW YORK
From The Economist print edition

The recession forces agencies to branch out

ADVERTISING agencies have been worrying for years that advertising alone will not pay enough to keep them afloat. This year their clients' slashed ad budgets have heightened that anxiety. As a result, many have branched out. Richard Kirshenbaum, co-chairman of Kirshenbaum Bond + Partners (KBP), a New York-based agency, says the industry's "business model is more like an accordion. We keep stretching it to meet our clients' needs." KBP has expanded by adding several divisions that are separate from its core business, including a public-relations unit and Varick Media Management, a data-analysis and investment-management firm launched last year.

KBP is not alone. Euro RSCG, a unit of Havas, a French advertising group, acquired its own music label, called The Hours, in 2008. It has signed budding artists and is hoping for their stardom, not least because it will help fill the firm's coffers. Havas, too, has branched out into an area not typically associated with advertising by acquiring Cake, a British entertainment and event-planning agency. In May Ogilvy & Mather, a subsidiary of WPP, an advertising conglomerate, launched OgilvyEarth, which advises firms on greenery. It also started a separate Recession Marketing Practice this year to counsel companies on how to use their marketing budgets wisely.

Some agencies have tired of coming up with clever ideas for clients without winning a share of the resulting revenues. So BBH, a global advertising firm, has set up a unit called Zag, which designs, markets and distributes its own products. Its successes include a range of prepackaged vegetarian food sold at Tesco, a British supermarket, and a security device that imitates the sound of a woman's scream. BBH hopes Zag will provide a quarter of its revenue within two years, though that target remains distant. Another agency, Anomaly, has decided to focus on developing its own intellectual property; advertising accounts for less than half of its revenue.

Moonlighting may sound appealing. But it will not be the singular solution to the industry's troubles, argues Miles Young, Ogilvy's boss. He believes it is "downright dotty" for agencies to expand into areas that are not an extension of their core expertise. Besides, the grim economic climate does not favour such dabbling. It takes cash and time to develop a fledgling unit. Those are two things that many agencies do not have.

Face value

A Viennese grind

Jul 30th 2009
From The Economist print edition

The troubles of Julius Meinl V illustrate the complicated consequences of the property crash

Reuters

MEET Julius Meinl V in a bar in Belgravia and he seems the epitome of the well-bred Englishman, with no trace of an accent. In fact he carries a British passport, although the Austrian authorities impound it when he is in their country. On April 2nd they arrested him, releasing him only when he posted a record bail of €100m, or $130m—13 times more than the American authorities asked of Bernard Madoff. Although he is allowed to travel, Viennese prosecutors continue to investigate him for suspected breach of trust and deception of investors.

Tens of thousands of Austrians blame Mr Meinl for losses on share certificates which bore the Meinl brand, a responsibility he emphatically rejects. That brand, and the family that created it, are woven into the fabric of Austrian history. His great-great-grandfather, Julius I, started selling roasted coffee beans in Vienna in 1862. Twenty years later he had his own roasting factory serving the whole of Austria-Hungary. After the first world war the Meinl grocery business spread through central Europe. It enjoyed a revival there after the cold war ended in 1989.

The Britishness is an accident of history. While Julius II kept the firm going under the Nazis, Julius III and his Jewish wife fled to Britain in 1939, along with their son Julius IV. Julius V was born there in 1959. Julius IV sold the Austrian stores in 1998, but kept one landmark food emporium in Vienna and the family's property portfolio in central Europe. Julius V went into investment banking in London and New York, after an education in Vienna and St Gallen, Switzerland. In 1983 he took over Meinl Bank, the family banking arm, and gradually changed it from a small savings bank into an investment bank and fund-management firm.

By 1997 Mr Meinl had found a new way to make the bank money: he spun much of the family property portfolio into Meinl European Land (MEL), a company domiciled in Jersey but listed in 2002 on the Vienna exchange. MEL, at which Mr Meinl had no formal role, then sold shares (in the form of certificates enshrining a claim on a share) to a wide public. For Meinl Bank, providing investment-banking services to MEL was a gold mine, yielding €322m between 2003 and 2007. In 2006 it accounted for 60% of the bank's earnings. But the ties between MEL and Meinl Bank attracted little scrutiny as long as the property fund prospered.

In February 2007 MEL issued 75m new share certificates to raise around €1.4 billion of capital, with Meinl Bank again handling the transaction. But the subprime crisis that had begun in America was beginning to infect the central European property market, making the role of underwriter a risky one. The bank says

the entire issue was placed with international investors. But a large number of certificates ended up in the hands of Somal, a Netherlands Antilles subsidiary of Julius Meinl AG, a Liechtenstein trust founded by the family.

Anyone left holding the certificates would have faced big losses as property values plunged had MEL not decided to support its sagging share price by buying back 52m of them, which it did between April and August 2007. When MEL announced the planned (but mostly already executed) buyback to the Vienna Stock Exchange on July 27th 2007, its share price nosedived anyway. Investors were in uproar at a general meeting a month later and the Meinl affair became a full-blown scandal. By that stage MEL had apparently frittered away €1.8 billion in a vain attempt to support its share price, without investors' approval.

The questions still raging in Austria and Jersey are: who authorised the buyback and was it legal under the island's law? Two members of MEL's board at the time, who are Jersey lawyers, told the Jersey Financial Services Commission (JFSC) that they had been kept in the dark about the buyback. Other board members sought legal opinions, but, it seems, only after the fact, according to e-mails published recently in *Format*, an Austrian weekly, which appear to have been leaked from the prosecutor's office. The opinions were contradictory. Bedell Cristin, a Jersey law firm, said a buyback would need shareholder approval. Yet a senior English barrister opined that since the buyback involved certificates not shares, approval was not needed, though "it would be appropriate and desirable". An investigation by the JFSC continues. But Austria's Financial Market Authority (FMA), has fined MEL's board members €20,000 each for misleading the market. Citicorp Trustee Company, which acts as trustee for bonds issued by MEL, wrote in June that it regarded the buyback as illegal.

Settling accounts

Underlying these questions is the suspicion, frequently aired in the Austrian press but emphatically denied by Mr Meinl, that the buyback was intended to benefit Meinl Bank at the expense of MEL's shareholders. The FMA asked the central bank to investigate Meinl Bank. The Vienna prosecutor swung into action this February, ordering raids on various premises in Austria and Slovakia relating to the bank or Mr Meinl. Six weeks later Mr Meinl was called in for questioning and arrested.

Mr Meinl and his bank are fighting to defend their reputation. On July 2nd they scored a small victory when one of the prosecutors was taken off the case for having penned an anti-Meinl article in September 2007. A string of press releases and full-page advertisements have refuted all the allegations that have appeared in the newspapers. Mr Meinl argues that his bank performed honest work on MEL's behalf, at market rates, and made no attempt to influence MEL's management. The buyback can be construed as part of MEL's strategy to sell a stake to a strategic investor (a year later two investors did indeed buy into MEL, changing its name to Atrium and paying severance and other fees to Meinl Bank of €240m). Investors, meanwhile, got back a fraction of their money. Some say Mr Meinl's €100m bail, paid by a source in Liechtenstein, should be used to defray their losses. He, naturally, demurs. The legal grind continues.

The collapse in commercial property

Towers of debt

Jul 30th 2009
From The Economist print edition

Concerns are switching from the residential to the commercial sector

Illustration by S. Kambayashi

FROM a distance Potsdamer Platz looks a bit like its old self. Once the central hub of Berlin, before it was turned into a rubble-strewn no-man's-land divided by the Wall, it is now surrounded by shiny new towers. Get a little closer, however, and it becomes clear that many buildings are just façades painted onto giant hoardings that rise ten stories high between actual office blocks.

This subterfuge makes for a far more pleasant view than that provided by vacant lots. It also points to an unusual degree of restraint among developers in Europe's second-largest property market (by transactions). The commercial-property market in most other parts of the developed world is in deep trouble.

Unlike other property busts, this downturn has not been driven by speculative overbuilding but by investors' overenthusiasm. Commercial property was a popular asset class for much of this decade. Institutional investors who lost a lot of money when the dotcom bubble burst were persuaded that switching from the stockmarket into property would diversify their portfolios and reduce their risk. Cheap finance was plentiful. Investors could indulge in a version of the "carry trade"—borrowing at a low interest rate to buy buildings and counting on the rental yield and capital growth to more than cover their financing costs.

That strategy looked smart when rents and capital values were rising and vacancy rates were low. But as cheap financing has dried up and economies have tumbled into recession, investors have become badly exposed. According to Marcus & Millichap, an estate agent, the office-vacancy rate in Manhattan climbed by more than three percentage points in the first half of the year, to 11.2%. As tenants have disappeared, rents have fallen too—by 16% over the past year, Marcus & Millichap reckons.

Property prices have also been badly hit. Moody's, a rating agency, estimates that American commercial-property prices dropped by 7.6% in May alone, leaving them almost 35% below their peak in October 2007. Prices would have gone down even further had not transactions dried to a trickle (see chart). Owners are loth to sell into a falling market, although some distressed sales are occurring.

All this sounds like a replay of the downturn in the residential-property market, where easy borrowing terms allowed homebuyers to push prices to extreme levels. To add to the sense of déjà vu, property loans have also been bundled into complex financial instruments, known as commercial mortgage-backed securities (CMBSs). The riskiest of these, mainly those issued between 2005 and 2007, are now running into trouble.

Realpoint, a credit-rating agency, says that nearly $29 billion of CMBSs, around 3.5% of the total, have become delinquent (ie, borrowers have not kept up interest payments) in the past 12 months. It thinks the delinquency rate could reach 6% by the end of the year. Richard Parkus of Deutsche Bank reckons the default rate could eventually reach 12%. Together with bad construction loans, that could push the losses of American banks on commercial property to $200 billion-230 billion. Many small banks will go under as a result.

European banks are exposed to property, too. The good news is that the two biggest euro-zone economies, France and Germany, have seen only modest declines in rents and prices. But one of Italy's biggest property companies, Risanamento, is fighting to stave off its creditors. And pain is being felt all around the periphery of the euro area. In Spain (see article) and Ireland vacancies are surging, property prices are plummeting and cranes are standing idle.

Prices are plunging across central and eastern Europe, too, although the volume of transactions remains slim. Yields in many of these markets were driven down by hopes that they would, in time, converge with those in mature European markets. Vacancy rates in cities such as Budapest have surged to about 15% while those in Prague have almost doubled (to roughly 10%) over the past year. Some of the biggest falls in rents are taking place in Russia. Rents in Moscow have fallen by 63% in the 12 months to the end of June although they are still the third-highest in Europe (after the West End in London, and Paris). With almost one-fifth of office space empty, further falls in rents and prices seem likely.

Asia has not been spared either. The worst-affected property markets in the region have been financial centres such as Singapore and Hong Kong. Shrivelling bank balance-sheets have meant shrinking demand for office space, as armies of bankers have lost their jobs. Singapore's swankiest business district led the retreat in office rents across the region, shedding more than half between June 2008 and June 2009, according to Cushman & Wakefield, a consultancy. Hong Kong was not far behind with a 43% drop in the same period. Mumbai (down by 40%) and Shanghai (32%) were the next hardest hit.

There are some signs that the speed of the downward adjustment is slowing. In Hong Kong, office rents in the prime central district declined by 20.1% in the first quarter. The fall was much more moderate, but still 10.4%, in the second. Looking ahead, Singapore seems particularly dicey, because 8.3m square feet (770,000 square metres) of new office space will be coming into the market by 2013. According to CLSA, a broking firm, oversupply will also weigh heavily on office property in China. Vacancy rates in Shanghai and Beijing could rise to 35% in 2010 from around 17% and 22% respectively today.

A year ago everyone was worried about losses on residential-property loans. If the latest data are any guide, both American and British house prices may be finding a bottom. Concerns are now switching to the commercial sector. History suggests downturns in that market last for years, rather than months. Almost 20 years have passed since the Japanese property market peaked. Prices still fell by 4.7% last year.

Spain's property market

Tricks and mortar

Jul 30th 2009 | MADRID
From The Economist print edition

The central bank makes life a little easier for lenders

AP

A soaring problem

SPANISH banks have been doing their best to shield themselves from the bursting of the country's property bubble. By buying properties before the loans on them go bad, lenders can mask their worst bets. Restructuring loans has the same effect. Help is now at hand from an unlikely source: the normally sober Bank of Spain. In July the central bank circulated guidance that relaxed provisioning rules on risky mortgages.

The change makes some sense. Until now, banks have had to make provision for the full value of high-risk loans—those above 80% of the property's value—after two years of arrears. That was far too demanding, since property values rarely fall to zero. Under the new rules, they only have to allow for the difference between the value of the loan and 70% of the property's market value.

Yet the timing is terrible, mainly because the move follows heavy lobbying from the banks. The Bank of Spain maintains that the net effect on the system will be neutral since it is also tightening rules for bad consumer loans. But the impression is that Spain's central bank—one of the few to emerge from the crisis in credit—has moved the goalposts to help banks deal with the onslaught of bad property loans.

For Spain's two largest banks, Banco Santander and BBVA, which have diversified abroad and reported decent second-quarter results this week, the new guidance will probably have only a marginal effect. But it will be a boon to smaller lenders with greater exposure to risky loans. Iñigo Vega, an analyst at Iberian Equities, estimates that the new rules would relieve banks of the need to make provisions of about €22 billion ($31 billion) in coming months (assuming non-performing loans reach 8% by the end of 2010). To put that into context, Spain's savings banks, which are heavily exposed to developers, are expected to make profits of only €16 billion before provisions this year.

The new accounting guidelines will help Spanish lenders smooth out the effects of the property bust over time. But the risk is that the problems are merely postponed. The ratio of bad loans to the total, property included, has tripled to 4.6% over the past 12 months as unemployment appears to head inexorably towards 20%.

The true picture is worse still. Commercial banks have bought about €10 billion in debt-for-property swaps, according to UBS. Spain's savings banks do not disclose the figure. Assume it is similar to their commercial peers and reclassify all these property purchases as bad loans, and then the non-performing loan ratio would be 5.7% (before any further adjustments for loan restructuring). Deferring losses to *mañana* doesn't change the extent of the difficulties facing Spain's financial system.

Financial reform in America

Wobbling

Jul 30th 2009 | NEW YORK
From The Economist print edition

Barack Obama's financial reforms meet political reality

"IN THESE efforts we seek a careful balance," Barack Obama declared as he unveiled his financial reforms on June 17th. Not equitable enough for some, it seems. With lawmakers, regulators and bankers blowing raspberries at crucial parts of the package, the odds are moving against its becoming law by the end of the year, as originally envisaged. Worse, passage looks increasingly dependent on the most contentious bits being rewritten.

The Treasury's work rate cannot be faulted. It has sent hundreds of pages of proposed legislation to Congress in recent weeks on pay, securitisation, hedge funds, rating agencies and more. The final piece, on derivatives, is expected soon. The House of Representatives was expected to approve the compensation bill, curbing egregious pay-offs and giving shareholders a vote on pay, on July 31st.

But the overall timetable is slipping. There is no consensus on who should supervise the largest financial firms. The administration wants the Federal Reserve to do this, supported by a council of regulators that keeps a lookout for emerging risks. But lawmakers on both sides worry that the central bank is already too powerful, or that expanding its role would undermine its monetary credentials. Barney Frank, the House financial-services committee's ebullient chairman, has criticised plans to draw up a list of firms that are "too big to fail", fearing it will entrench them.

The loudest opposition has been reserved for a proposed consumer-protection agency, which would write and enforce rules for mortgages, credit cards and so forth. This is needed, the administration argues, because bank regulators are inclined to focus on safety rather than the treatment of customers—even if they have recently become, in Mr Frank's words, "born-again consumer advocates", rushing out new curbs on predatory lending as their turf has come under threat.

Lawmakers would like to support the new agency—there are votes in championing the little guy. But banks, including politically powerful community lenders, have stoked fears that the new regulator could become an unwieldy monster and that its mandate to make products simpler could constrain credit. Existing regulators have weighed in too, arguing that separating prudential regulation from consumer protection could make the system less safe. A House vote on the agency, scheduled for July, has been postponed until September because of lukewarm support.

All this cacophony is good news for industry lobbyists, who are also encouraged by the delays plaguing health-care reform, Mr Obama's top priority. This will distract Chris Dodd, who is essential to getting the financial reforms through the Senate as head of its banking committee but must first shepherd the health package. "The longer this drags on, the less draconian the outcome should be, as long as markets continue to mend," says one lobbyist.

No one doubts that the financial package will pass eventually, and that the final product will still contain plenty to furrow the lobbyists' brows. Higher capital requirements are a given, as is the consumer agency, in some form. So too are restrictions on the size and nature of derivatives bets, a point reinforced this week by the head of the Commodity Futures Trading Commission. But the administration is set to get less of what it wanted, and later.

Buttonwood

With one bound...

Jul 30th 2009
From The Economist print edition

The stockmarket recovery still faces some serious tests

Illustration by S. Kambayashi

FACING certain death, Batman can always produce just the right tool from his utility belt and leap to safety. The stockmarket seems to be working on the same trick. In March shares were spiralling relentlessly downwards. But the Dow Jones Industrial Average climbed back above the 9,000 level on July 23rd and London's FTSE 100 index rose for 11 trading days in a row to July 27th, equalling its best-ever run. Most of the world's stockmarkets are now in positive territory for the year.

Such rises need to be set in context. The Dow passed 9,000 for the first time back in April 1998 and it is still a long way below its peak of 14,165, reached in October 2007. The speed of this year's rally in part reflects the scale of the previous decline. Nevertheless, the change of mood is remarkable, given that earlier this year many feared a repeat of the Depression.

Two factors are commonly cited as being behind the rally. The first is a growing conviction that the worst of the economic downturn is over. Although second-quarter GDP data have so far been mixed (disappointing in Britain, better than expected in Singapore), forward-looking data such as purchasing managers' surveys are generally encouraging.

The second factor is the second-quarter reporting season in America. According to Morgan Stanley, 57% of companies in the S&P 500 index to have reported results have beaten expectations. Only 25% have disappointed. It is worth remembering, though, that profits are still depressed. Earnings were 28.8% lower than in the same period of 2008. Leaving out financial firms, they were still 16.7% down.

The rally may also be benefiting from at least two virtuous circles. The first is that leading economic indicators usually include the stockmarket itself as a key component. Recent improvements in these indicators—the euro-zone figures rose by 1.5% in June, for example, on the back of similar increases in April and May—are in turn taken by equity investors as a bullish signal.

The second factor is more technical. David Shairp of JPMorgan Asset Management says that lower stockmarket volatility is reducing the perceived risk of investing in equities, relative to bonds. In turn, volatility tends to fall when the stockmarket is rising.

The relative attraction of equities may be the key to the rally. The return on cash is many countries is virtually zero. Long-dated government bonds yield 3-5% in America and the euro zone. Many investors are nervous about the volume of issuance and the potential for inflation. At the end of 2008 these low yields did not matter: investors were more concerned with the return of capital than the return on it. They are now becoming less risk-averse and heading back to equities and to corporate bonds, where spreads (the excess interest rate paid to investors to reflect higher risks) have fallen despite more defaults.

How long-lasting will the recovery be? Its scale has hurt one bullish argument for shares: that they are historically cheap. At their March lows they did appear attractive on two long-term measures—the cyclically adjusted price-earnings ratio (which averages profits over ten years) and the "q" ratio (which compares the market value of companies to the replacement cost of their assets). After the rebound, Andrew Smithers, an economist, reckons the American market is about 20% overvalued on these gauges.

The period when shares were a bargain was remarkably short. As Jeremy Grantham, a veteran investor, has remarked: “After 20 years of more or less permanent overpricing of the S&P, we get five months of underpricing. There is no justice in life.” Mr Grantham’s lament reflects an underlying problem: valuation often fails to be a good short-term guide to the stockmarket’s prospects.

The big issue for the market may arrive, ironically, if the bulls are right. If economic recovery does occur in 2010, it will be because the authorities have thrown everything, from tax cuts to quantitative easing, at the problem. At some point they will have to withdraw the stimulus. How will consumers cope if both taxes and interest rates are rising at the same time? American consumer confidence has already declined in each of the past two months, even though rising share prices are normally good for sentiment.

If governments and central banks do not tighten policy, government-bond investors may take fright, pushing up yields and tightening monetary conditions on their own. In short, there are plenty of risks. Batman may win every hand but equity investors should still fear the Joker.

Economist.com/blogs/buttonwood

High-frequency trading

Rise of the machines

Jul 30th 2009
From The Economist print edition

Algorithmic trading causes concern among investors and regulators

THE arrest of a former Goldman Sachs employee in July for allegedly stealing the firm's proprietary computer codes thrust the arcane world of high-frequency trading (HFT) into the spotlight. The glare of attention is intensifying. High-frequency traders are essential providers of liquidity—accounting for roughly 50% of trading volume on the New York Stock Exchange—and can claim to have squashed bid-ask spreads. But many claim HFT comes at the price of gouging other investors.

The basic idea of HFT is to use clever algorithms and super-fast computers to detect and exploit market movements. To avoid signalling their intentions to the market, institutional investors trade large orders in small blocks—often in lots of 100 to 500 shares—and within specified price ranges. High-frequency traders attempt to uncover how much an investor is willing to pay (or sell for) by sending out a stream of probing quotes that are swiftly cancelled until they elicit a response. The traders then buy or short the targeted stock ahead of the investor, offering it to them a fraction of a second later for a tiny profit.

Another popular HFT strategy is to collect rebates that exchanges offer to liquidity providers. High-frequency traders will quickly outbid investors before immediately selling the shares to the investor at the slightly higher purchase price, collecting a rebate of one-quarter of a cent on both trades. Other tactics include piggybacking on sharp price movements to increase volatility, which increases the value of options held by traders. The speeds are mind-boggling. High-frequency traders may execute 1,000 trades per second; exchanges can process trades in less than 500 microseconds (or millionths of a second).

Asymmetric information is nothing new. Even its critics concede that most HFT is perfectly legal. But some of the advantages that accrue to high-frequency traders look unfair. Flash orders, a type of order displayed on certain exchanges for less than 500 microseconds, expose information that is only valuable to those with the fastest computers. By locating their servers at exchanges or in adjacent data centres traders can maximise speed. "It appears exchanges are conspiring with a privileged group of high-frequency traders in a massive fraud," says Whitney Tilson, a fund manager. Requiring orders to be posted for at least a second would nullify the value of flash orders and of probing the market.

A group that accounts for nearly 50% of a market also introduces systemic risk. Lime Brokerage, a technology provider, has raised the prospect of a rogue algorithm going awry. Many believe that last year's extreme market volatility was heightened by high-frequency traders. According to Nassim Nicholas Taleb, an author and investor, HFT "magnifies changes and ultimately makes the system weaker".

The market can correct some of these problems. Institutions are developing their own algorithms to confuse high-frequency traders. Bigger investors are moving to "dark pools", electronic trading venues that conceal an order's size and origin. The London Stock Exchange announced in July that it was abolishing liquidity rebates. Regulators are also rolling up their sleeves. On July 24th Charles Schumer, a Democratic senator, urged the Securities and Exchange Commission to ban flash orders. As trading moves from milliseconds to microseconds to nanoseconds, everyone is learning to act more quickly.

Remittances to developing countries

What goes up

Jul 30th 2009
From The Economist print edition

Remittances rose in 2008. This year will be different

THINGS that grew rapidly in 2008 included home foreclosures, government deficits and the ranks of the jobless. More encouragingly, remittances to developing countries also expanded. The World Bank reckons that migrant workers sent $328 billion home to their families last year, 15% more than in 2007.

This continued growth is particularly striking because it came in a year when other private financial flows into the developing world declined dramatically. The net inflows of private capital to these economies dropped by nearly two-fifths, from $1.16 trillion in 2007 to $707 billion, as panicky rich-world investors turned inward and foreign banks became increasingly reluctant to lend across borders. Dilip Ratha of the World Bank wryly remarks that migrants are being “thrust into the role of a sort of lender of last resort.”

However, the chances that remittances will continue to hold up this year are slim. Some argue that these payments are less affected by downturns than other kinds of financial flows because they are sent primarily to support people’s families. But whatever their motives, migrant workers must earn before they can remit. And this crisis has hit countries where migrants work harder than the countries they come from.

The continued growth in remittances in 2008 may not reflect their resilience to recession so much as the fact that it takes a few months for changes in host economies to have an effect. Remittances to Mexico, which are dominated by money from Mexicans working on American building sites, follow the upticks and downturns in American housing starts with a lag of a few months (see chart). As with Mexico, remittances to Guatemala and El Salvador, most of whose migrants are also in America, were at least 10% lower in the first half of this year than in the same period in 2008. America was the first big economy to enter recession so it may only be a matter of time before flows from other countries also fall.

And the shallower the recovery in the rich world, the more unemployment will rise. Spain and the Czech Republic are already offering to pay migrant workers to go home. Other governments, from Italy to South Korea, have reduced the number of temporary workers they let in. The World Bank is forecasting a decline in remittances of 7-10% in 2009.

Rebalancing the world economy: China

The spend is nigh

Jul 30th 2009 | HONG KONG
From The Economist print edition

The second article in our series on global rebalancing asks whether China can reduce its trade surplus by consuming more

A REBALANCED global economy requires America to consume less and save more. That means the world's three big surplus economies—China, Germany and Japan—will have to save less and spend more. None is under more scrutiny than China, whose vast current-account surplus has been fingered by some as the ultimate cause of the financial crisis. The case against China is exaggerated but a surplus of more than $400 billion in 2008, or 10% of GDP, was clearly too big. Can China right its trade imbalances, and if so, how will it achieve rapid growth in future?

The good news is that the surplus is already shrinking. The strong rebound in China's economy in the second quarter—pushing GDP 7.9% higher than a year ago—came entirely from domestic demand. This sucked in more imports, while exports continued to slump. China's merchandise trade surplus narrowed to $35 billion in the same quarter, 40% down on a year earlier. Yu Song and Helen Qiao of Goldman Sachs calculate that the decline is even more impressive in real terms (adjusting for changes in export and import prices), with the surplus shrinking to less than one-third of its level a year ago (see chart 1). They even suggest that a monthly trade deficit is possible within the next year.

Another way to look at the huge swing in China's trade is that net exports (exports minus imports) contributed 2.6 percentage points of the country's GDP growth in 2007, but shaved almost three points off its growth in the first half of this year.

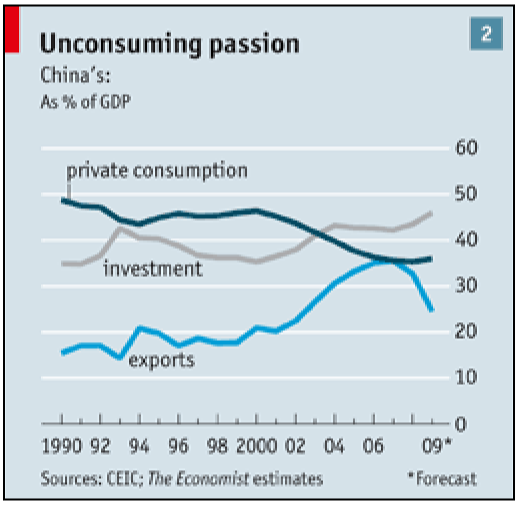
Most economists think that China's trade surplus will remain large. The jump in imports in the second quarter included heavy stockpiling of commodities, which will not last; copper imports, for example, were 150% higher than a year ago. Yet the underlying surplus is clearly shrinking. Paul Cavey of Macquarie Securities forecasts that China's current-account surplus will fall to under 6% of GDP this year and 4% in 2010, down from a peak of 11% in 2007. Exports amounted to 35% of GDP in 2007; this year, reckons Mr Cavey, that ratio will drop to 24.5%.

On the surface, therefore, China is fulfilling the long-standing demand of Western governments that it shift its engine of growth from exports to domestic demand. Thanks to the biggest fiscal stimulus and loosening of credit of any large economy, China's real domestic demand is likely to grow by at least 10% this year. In fact, the popular perception that China has always relied on export-led growth is rather misleading. Its current-account surplus did soar from 2005 onwards but until then was rather modest. And over the past ten years net exports accounted, on average, for only one-tenth of its growth.

The problem is more that the mix of domestic demand between consumption and investment is unbalanced, and becoming even more so. In 2008 private consumption accounted for only 35% of GDP, down from 49% in 1990 (see chart 2). By contrast, investment had risen from 35% to 44% of GDP. This year the bulk of the government's stimulus is going into infrastructure, further swelling investment's share. Chinese capital spending could exceed that in America for the first time, while its consumer spending will be only one-sixth as large. This is China's most glaring economic imbalance.

Spending lots of money on building railways, roads and power grids is the most effective way for the government to prop up demand in the short term—especially since China, as a poor

country, needs better infrastructure. However, the pace of investment is unsustainable. Even before this year's infrastructure boom capital spending was too great, causing many economists to worry about excess capacity and the risk that bank loans could sour.



China deserves credit for the speed with which it responded to the global downturn. Now it needs to focus on structural reforms not just to keep domestic demand growing strongly and to reduce its trade surplus further, but also to derive more of its growth from consumption and less from investment.

Before exploring how China can do so, it is important first to clear up a misunderstanding. It is often argued that China runs a current-account surplus because its consumer spending has been sluggish. On the contrary, China has the world's fastest-growing consumer market, increasing by 8% a year in real terms in the past decade. Retail sales have leapt by 17% in real terms in the past 12 months, although this figure may be inflated by government purchases. Even so, China's consumer spending has grown more slowly than the overall economy. As a result consumption as a share of GDP has fallen and is extremely low by international standards: only 35%, compared with 50-60% in most other Asian economies and 70% in America.

Economists disagree about the main reason why the consumption ratio has fallen—and hence about the best way to lift it. The most popular explanation is that Chinese households have been saving a bigger slice of their income because of an inadequate social safety net. They have squirrelled away more money to cover the future cost of health care, education and pensions. According to Eswar Prasad, an economist at Cornell University, the saving rate of urban households has jumped from 20% to 28% of their disposable income over the past decade. After exploring all the possible causes, he concludes that uncertainty about the private burden of health care and education is indeed the main culprit. The effect has been worsened by an undeveloped financial system, making it hard for households to borrow.

Panos

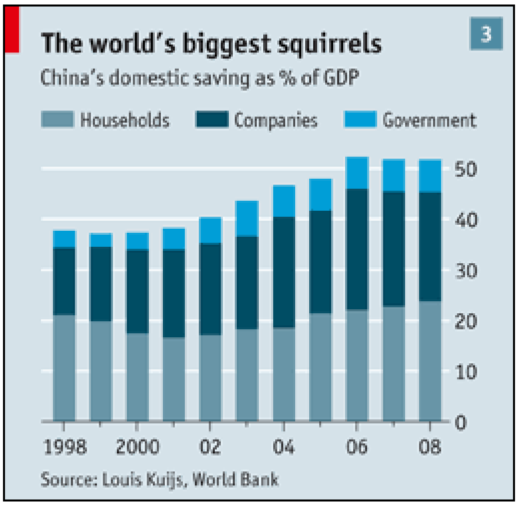
The Beijing government is acting: it doubled spending on health care, education and social security between 2005 and 2008. But the total amount remains low at only 6% of GDP, compared with an average of around 25% in OECD countries. This year the government has increased pensions coverage and payments to low-income households. It has also pledged to provide basic health care for 90% of the population by 2011, although the new spending appears to be less than 0.5% of GDP each year. If such measures ease households' worries about future health care, they could encourage them to save less. But it will take years for them to have much effect on consumer behaviour.

Slicing up saving

More to the point, an inadequate welfare state does not fully explain why consumption has fallen as a share of GDP. The first niggle is that most workers lost their state-provided health care and education almost a decade ago, after the reform of state-owned firms, so this cannot really explain why saving has continued to rise more recently. Louis Kuijs, an economist at the World Bank in Beijing, suggests that the extra saving may owe as much to greater income inequality as to the lack of a welfare state. Rich people save a lot more and their numbers have increased.

A second flaw in the thesis is that although urban households have been saving more, rural households have become less thrifty over the past decade. As a result China's average household-saving rate has risen more modestly. Mr Kuijs calculates that total household saving has risen from 21% of GDP in 1998 to 24% in 2008. Households accounted for only one-fifth of the increase in total domestic saving over the period. Most of the increase in saving came from companies (see chart 3).

This matters for two reasons. First, if anyone saves too much, it is companies, not households. Second, you need to look elsewhere for the cause of China's falling consumption ratio. The drop in consumer spending as a share of GDP over the past decade has been almost four times larger than the rise in household saving.



The more important reason why consumption has fallen is that the share of national income going to households (as wages and investment income) has fallen, while the share of profits has risen. Workers' share of the cake has dwindled because China's rapid growth has generated surprisingly few jobs. Growth has been capital-intensive, focusing on heavy industries such as steel rather than more labour-intensive services. Profits (the return to capital) have outpaced wage income.

Capital-intensive production has been encouraged by low interest rates and by the fact that most state-owned firms do not pay any dividends, allowing them to reinvest all their profits. The government has also favoured manufacturing over services by holding down the exchange rate as well as by suppressing the prices of inputs such as land and energy.

Simply urging households to spend a bigger slice of their income will not be enough to shift China's growth towards consumption. Beefing up the welfare state is important but policy also needs to focus on how to lift household income and reduce corporate saving, says Mr Kuijs. Making growth more labour-intensive will require lots of difficult reforms. China needs financial-sector liberalisation to lift the cost of capital for state-owned companies and improve access to credit for private ones, especially in services. Higher deposit rates would also boost household income. Distortions in the tax system which favour manufacturing and barriers to private-sector participation in some service industries should be scrapped. State-owned firms ought to be forced to pay bigger dividends. The prices of subsidised industrial inputs should be raised. Land reform and the removal of restrictions on migration from rural to urban areas would also help to lift incomes and thus consumption.

China has barely started on these important reforms. That may be because they involve much harder political decisions than creating a welfare state. They require the government to loosen its control over the economy, something which Beijing will do slowly and reluctantly.

Last but not least, China needs to allow its exchange rate to rise. This would lift consumers' real purchasing power, discourage excessive investment in manufacturing and help to reduce the trade deficit further. It would also alleviate the risk of a protectionist backlash abroad. From July 2005 (when China abandoned its dollar peg) to February 2009, the yuan rose by 28% in real trade-weighted terms, according to the Bank for International Settlements. But alarmed by the collapse of exports, China has virtually repegged the yuan to the dollar over the past 12 months. As the greenback fell this year, it dragged the yuan down with it. Since February the yuan's real trade-weighted value has lost 8%.

Economists disagree about the extent to which the yuan is undervalued. In the IMF's "Article IV" assessment of China, published on July 22nd, officials were split over whether the currency was "substantially undervalued". Morris Goldstein and Nicholas Lardy, of the Peterson Institute for International Economics, have done some of the most extensive work on China's exchange rate. In a new study, they estimate that the yuan is undervalued by 15-25%, based on the adjustment needed to eliminate the current-account surplus.

The American government has softened its demands for revaluation, largely because it needs China to keep buying Treasury bonds to fund its own stimulus spending. At the Strategic and Economic Dialogue meeting between American and Chinese officials on July 27th and 28th in Washington, DC, the yuan's exchange rate was barely discussed. However, the case for appreciation remains strong.

China's recent efforts to boost domestic spending have helped to maintain robust growth and reduce its

trade surplus. But excessive levels of investment are not a recipe for sustained rapid growth. Unless it is prepared to embrace difficult structural reforms and to allow the yuan to climb, China's commitment to rebalancing will remain half-hearted. In the long run that will be bad news for China itself as well as for the rest of the world.

Video: See the changing face of China's economy at: Economist.com/videographics

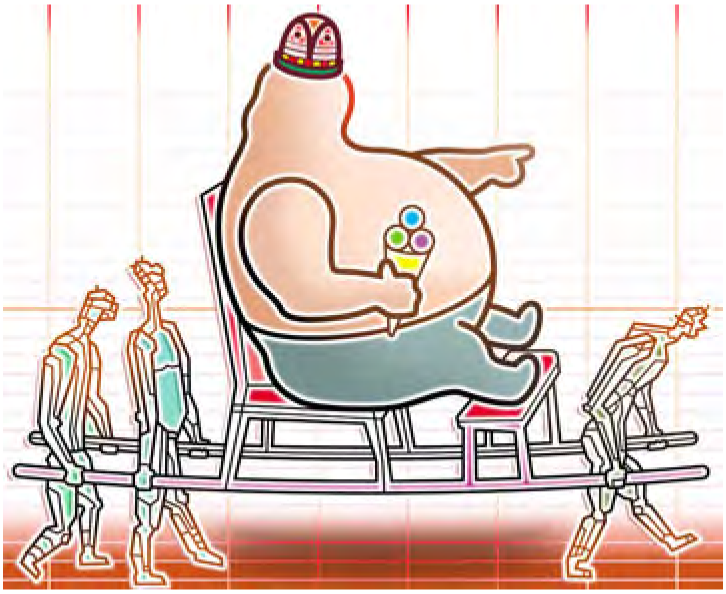
Economics focus

Waist banned

Jul 30th 2009
From The Economist print edition

Does a tax on junk food make sense?

Illustration by Jac Depczyk



ECONOMISTS have long recognised the arguments for imposing special taxes on goods and services whose prices do not reflect the true social cost of their consumption. Such taxes are known as "Pigouvian" after Arthur Pigou, a 20th-century English economist. Environmental taxes are an obvious example. There is also a Pigouvian case for duties on cigarettes, alcohol and gambling. Smoking increases the risk of cancer for those in the vicinity of the smoker; alcohol abuse and gambling are strongly associated with violence and family breakdown. Moreover, all three habits lead to higher medical costs. In theory governments can make up these costs, or "externalities", with a tax that adjusts the prices people pay to puff, booze or punt. Such a tax might also encourage consumers to live healthier lives.

Support for another such tax, on junk food, is now spreading, especially in America. Congress is considering a tax on sugary drinks to help pay for the planned expansion of health-care coverage. Some analysts would like to see broader duties on junk food. On July 27th the Urban Institute, a think-tank in Washington, DC, proposed a 10% tax on "fattening food of little nutritional value" that, it claimed, would raise $500 billion over ten years.

The logic for a tax on fattening food may seem obvious. About one-third of Americans are obese, up from 15% in 1980. Fat people are more prone to heart disease, diabetes, bone disorders and cancer. An obese person's annual medical costs are more than $700 greater than those of a comparable thin person. The total medical costs of obesity surpass $200 billion a year in America, which is higher than the bill for smoking. These costs are not all borne by the obese. When health-care costs are shared, obesity becomes a burden for everyone. Thanks to government health-care plans such as Medicare half of America's obesity-related health costs land on taxpayers. In private employer-sponsored health plans the slim pay similar premiums to the overweight.

But would a fat tax affect behaviour? Numerous studies have shown a relationship between the price of food, especially junk food, and body weight. As fast food has become relatively cheaper, so people have become fatter. A new paper* from the RAND Corporation, another think-tank, suggests that taxing calories could have a sizeable, if gradual, effect on people's weight. The authors of the study look at changes in the weight and height of a large group of Americans aged over 50 between 1992 and 2004.

They then calculate food-price indices that are skewed towards calorie-dense foods (so a change in the price of butter has more impact than a change in the price of vegetables). By controlling for individual and environmental influences on weight, such as income and health, they then measure whether food-price changes affect body-mass index (BMI). BMI, the ratio of weight in kilograms to the square of height in metres, is a common, if imperfect, gauge of whether someone is over- or underweight.

A person's BMI turns out to be hard to shift in the short term. A 10% increase in the calorie-heavy price index is associated with a small decline, of 0.22, in BMI within two years. But the effects are greater over the longer term. A 10% increase in the price of calories results in a fall in BMI of one to two points over 20 to 30 years. Such a drop would eliminate about half of the observed increase in obesity in America since 1980.

Even so, the idea of tackling obesity via the tax system has some serious flaws. First, there is the question of what to tax. Sugary drinks may not be nutritious, but hamburgers contain some protein along with their fat. More important, junk food is not itself the source of the externality—the medical costs that arise from obesity. Unlike smoking, or excessive gambling and drinking, eating junk food does not directly impair the well-being of anyone else. And because obesity is determined by lack of exercise as well as calorie intake, its ultimate relationship with health costs is more tenuous than that of, say, smoking. It is possible to eat a lot of fatty food, exercise frequently and not generate any externalities. A more direct, though controversial, approach would simply be to tax people on the basis of their weight.

Fat chance

The distance between junk food and the medical costs of obesity means that a calorie tax could have unintended consequences. A new theoretical paper in the *Journal of Public Economics* even suggests that a tax on junk food could increase obesity, especially among physically active people. If junk food, which is quick and easy to obtain, becomes relatively dearer, people will spend more time shopping for fresh ingredients and preparing food at home. That could leave less time for exercise.

Even if perverse consequences of this type look improbable, a junk-food tax may have less impact than its advocates expect. New studies on the effect of cigarette and alcohol sin taxes suggest heavy users are less influenced by price changes than others. An analysis of data from the National Longitudinal Study of Adolescent Health shows that American teenagers who smoke more than five cigarettes a day are only one-third as responsive to cigarette prices as lighter smokers. A complementary study of data from America's Health and Retirement Survey shows that alcohol taxes are far less effective for the large minority of heavy drinkers. The biggest consumers of fattening food may prove similarly resilient to price increases, so a fat tax may do little to improve health, at least for today's junk-food addicts. If these same consumers are poorer on average, it would also be regressive. One reason for this is that in some poorer neighbourhoods there may be little fresh food on sale. If junk is all there is, putting up its price will reduce real incomes and make little difference to eating habits and health. Like the foods they aim at, fat taxes look appetising but can have nasty effects.

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* A full list of sources is available at Economist.com/fattaxes

Economist.com SCIENCE & TECHNOLOGY

Modern X-ray technology

Another look inside

Jul 30th 2009
From The Economist print edition

The way medical X-rays are generated is over 100 years old. Time to update it

Kobal Collection

WHEN Wilhelm Röntgen, a German physicist, was carrying out some experiments in 1895, he stumbled across a type of radiation which he labelled simply as X, because he did not know what it was. His X-rays did not remain unknown for long, however. Doctors seized on them to look inside living bodies and, later, engineers used them to examine the interiors of mechanical components. What has not changed much since Röntgen's day, though, is how they are made.

Most electronic devices have moved into the era of silicon chips and other solid-state technology. Not X-rays. The machines used to generate them still rely resolutely on vacuum tubes. But that will change shortly if Otto Zhou of the University of North Carolina has his way. Dr Zhou and his colleagues are bringing X-radiography into the world of modern electronics. In doing so they hope to create X-ray machines that are smaller, simpler and able to produce more detailed pictures. These could be used to enhance security screening at airports, to allow engineers to check the structure of materials more easily and, especially, to enhance medical images in a way that would improve cancer therapy.

At the moment, X-rays are produced by heating a negatively charged metal filament to a temperature of around 1,000ºC inside a vacuum tube. The combination of heat and charge releases electrons, which accelerate through the tube and strike a positively charged electrode at the other end. The rays are created by the energy of the impact. X-ray machines of this type have progressed over the years (the computed tomography, or CT, scanners used in hospitals collect hundreds of X-ray images taken from different angles and convert them into a three-dimensional picture of a patient's internal anatomy). But they are still, fundamentally, a century old.

Fields of endeavour

Dr Zhou's method, by contrast, employs a process called electron-field emission. This dispenses with the heat. Also, instead of having a single metal filament release the electrons, it relies on myriad carbon nanotubes to do the same thing. The result is a compact source of X-rays that can be controlled with great precision.

Such sources can then be built into an array, each element of which is programmed to fire whenever required. That will allow for more accurate CT scans. Existing scanners usually have but a single X-ray tube. This is rotated around the patient, taking pictures as it goes. Though the rotation takes only a few seconds, the overall image will be blurred if the patient moves. An array of field-emission devices, however, will take their exposures simultaneously, so the resulting image should always be pin sharp.

Dr Zhou has set up a joint venture with Siemens, a German company that builds CT scanners, to develop his technology for diagnostic imaging. A prototype machine, which has 52 field-emission X-ray sources arranged in a ring, is due to begin trials later this year. It was described to the annual meeting of the American Association of Physicists in Medicine, held this week in Anaheim, California. The new machine will be attached to a linear accelerator, a device used for radiation therapy, to allow simultaneous imaging and treatment, according to Sha Chang, who will lead the team that tests it.

Conventional CT scans are used to work out the shape of the place where a dose of radiation needs to be concentrated in order to attack a tumour without damaging nearby healthy tissue. But the scan and the treatment cannot usually be done at the same time, because they interfere with each other. There are, however, no interference problems with field-emission X-ray sources, so these can be used to take high-resolution pictures while treatment is proceeding. This means those administering the treatment will know with precision when to continue and when to stop.

And the precision of the new technology is remarkable. Dr Zhou’s colleagues have, for example, built tiny scanners that can X-ray a mouse’s heart and lungs by taking a series of exposures at exactly the same point in the heartbeat. They are even trying to produce beams so precise that they can be aimed at individual cells. That would allow a tumour to be destroyed cell by cell—probably not a practical anti-cancer therapy, but something which would allow researchers to learn more about how cancer cells interact with one another, and thus reveal their vulnerabilities in a way that was previously unimaginable.

Morality and colour

Dark for dark business

Jul 30th 2009
From The Economist print edition

The association of white with virtue and black with sinfulness is deep

THE virtuous are often said to be as "pure as the driven snow" while villains are frequently described as having hearts of coal or blackened souls. And the metaphor is made flesh (or, at least cloth) in many plays and films where the baddy wears black and the goody white. But how deep does the metaphor actually run, psychologically speaking?

That is the question which was asked by Gary Sherman and Gerald Clore of the University of Virginia. They were pondering a well-known tendency, called the "Macbeth effect", for people to want to clean themselves physically if they have acted unethically or even had thoughts of corrupt behaviour. (The name comes from the scene in Shakespeare's play in which Lady Macbeth desperately tries to wash phantom bloodstains from her hands after encouraging her husband to murder the king.) This association of cleanliness with moral probity is further bound up with the now well-established link between moral disgust (eg, at unusual sexual practices) and physical disgust (eg, at handling dirty objects or eating polluted food). The researchers' ponderings led them to wonder if the moral roles of black, which is roughly the colour of dirt, and white, which shows up the dirt so well, were connected with the Macbeth effect.

To explore this, they devised an experiment involving 27 Caucasian, six Asian, three African-American and two Hispanic students at the university. The students were all asked to state the colour of words that they were presented with as quickly as they could.

Such a technique is not new. Psychologists have long known that if people are presented with, say, the word "blue" printed in a blue font, they will be able to state the colour of the font much faster than if the word "red" is printed in the same blue font.

The study conducted by Mr Sherman and Dr Clore presented words of moral goodness, like "virtuous" and "honesty", and of badness, like "cheat" and "sin", in either black or white fonts on a computer screen. As they report in *Psychological Science*, the two researchers found that when "good" words were presented in black it took the participants about 510 milliseconds to state the colour of the word. When these same words were presented in white it took roughly 480 milliseconds—a significant difference. A similar effect was seen with "bad" words. Responding to white ones took around 525 milliseconds, whereas black ones needed only about 500. These results are remarkably similar to those found when words are printed in colours that clash with their meaning.

Besides illuminating an interesting corner of the Macbeth effect, Mr Sherman and Dr Clore suggest that their findings may have implications for understanding racial prejudice. Given that their work hints that blackness and immorality are psychologically connected, and that the labels "black" and "white" are often applied to race, dark skin might thus easily be associated with immorality and impurity.

Because most of the study group were white, and only three black, there is no way of detecting from the original data whether black people react in the same way as others, and thus whether the link between colour and disgust is independent of race. As a result, the two researchers are now conducting a follow-up study to look for racial differences.

That study is not yet complete but, according to Mr Sherman, "initial results are suggesting that this effect is not confined to Caucasians". Perhaps, then, one reason that so many black Americans get a bad rap is not just that their skin colour differs from that of the majority, but that their psychology, being the same as everybody else's, does not.

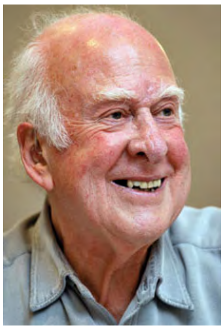
Improving scientific publishing

Huddled maths

Jul 29th 2009
From The Economist print edition

An academic journal provides haven for rejected work

AP



Second time lucky for Dr Higgs

PAUL LAUTERBUR, the father of magnetic-resonance imaging, had his seminal paper rejected when he first submitted it to *Nature*. Peter Higgs, eponymous predictor of physics's missing boson, faced similar trouble with *Physics Letters*. But Lauterbur went on to win a Nobel prize for his work, and Dr Higgs is an odds-on favourite to get one soon. A good, rejected paper, then, is by no means an oxymoron.

And that observation is the basis of *Rejecta Mathematica*, an open-source academic journal that recently went online. As its name suggests, the new journal publishes only papers that, like Lauterbur's and Dr Higgs's, have been previously submitted to, and rejected by, others. With *Annals of Mathematics*, one of the best, denying entry to more than 300 last year alone, *Rejecta* could be busy.

Rejecta was conceived three years ago by four graduate students at Rice University, in Houston, Texas. Two of its founders, Michael Wakin and Christopher Rozell, had just had a paper on card counting in blackjack rejected. Good work, said the reviewers, but find some other place for it. When they could not, they, along with Mark Davenport and Jason Laska, decided to cut out the middle man and found their own journal.

If *Rejecta* is a joke, it is a well-executed one. The serious aim is to highlight papers that, although perhaps flawed, may still be interesting. It manages that well. The inaugural issue includes topics ranging from image enhancement to condition numbers of matrices (don't ask). All come with an "open letter" in which the paper's author outlines in lay terms why the work was rejected (extra points awarded for bitterness), what has been done since and why it still has merit.

Rejecta's larger purpose, then, may be a light jab at academia's bureaucracy and the rigmarole to which it is necessary to submit in order to get published. Whether conventional journals are necessary in the internet age is a matter of active debate. Refereeing maths papers, in particular, requires serious expertise that few have. Those who do, usually receive no pay for their refereeing services. Mistakes can be made. Academia as a whole, some say, could do a better job. But peer review is still necessary. And yes, the editors claim that they too have had to reject some submissions.

Global warming and the permafrost

Thaw point

Jul 30th 2009 | TOOLIK LAKE, ALASKA
From The Economist print edition

Tundra is among the least-studied types of terrain on Earth. That is about to change

Getty Images

The beautiful and the dammed

THE Arctic tundra is one of the world's most extensive ecosystems, and the frozen soil known as permafrost, which underlies it, can be hundreds of metres deep. But as the world warms up in response to the millions of tonnes of carbon dioxide and other greenhouse gases being poured into the atmosphere each year, so does the permafrost. As the permafrost thaws, bacteria start chewing up the organic matter it contains. This releases yet more carbon dioxide, as well as methane, another greenhouse gas, which has 25 times the warming potential of CO_2. Edward Schuur of the University of Florida in Gainesville, a doyen of the field, estimates that the world's permafrost contains twice as much carbon as its atmosphere. If even a fraction of that were released as CO_2 and methane, it would be bad news.

Nor is that all. Thawing permafrost also leaks nitrates and phosphates into the tundra, allowing novel plant species to get a foothold in what was, to start with, a fairly spartan habitat. It distorts the Earth's surface, too, creating a landscape of domes and pits known as thermokarst because of its resemblance to the karstic terrain of limestone-rich parts of the world. This changes the tundra's ecology. It also plays havoc with human structures, such as buildings, roads and pipelines, that sit on top of it. For all of these reasons, then, more research is needed into this icy realm. And that is the object of a project with the unsnappy name of Spatial and Temporal Influences of Thermokarst Failures on Surface Processes in Arctic Landscapes, which was kicked off by a group of scientists who gathered in late June at the Toolik Field Station in northern Alaska.

Karsting the first stone

The project, which is led by Breck Bowden of the University of Vermont in Burlington, involves 17 research groups from America and Canada. To start with, they will use a combination of aerial photography, field measurements, and ground- and satellite-based sensors to compile a map of all the thermokarstic areas of Alaska. This will provide a reference point from which changes can be measured.

The team will then try to work out how the development of features such as "retrogressive thaw slumps" and "active-layer detachments" (different ways in which thawing permafrost can cause a hillside to slip) are associated with the local climate, geology and vegetation. They will look, too, at the amount of ice in the ground, and the temperature and the moisture of the soil. All these data will be fed into computer models which, the researchers hope, will allow them to develop an automated way of predicting where and when new features will form, and to monitor them when they appear.

Dr Bowden and his colleagues also hope to understand the impact of thermokarst activity on the structure of the soil, and its nutrient content. They will concentrate on a few sites that can be studied intensively and which are affected by different types of activity. They will measure the amount of carbon, phosphate and nitrate in the soil, together with the rate of plant growth and microbial decomposition. That will let them work out just how "leaky" thawing permafrost is and thus how big its contribution of greenhouse gases to the atmosphere might be, should the worst come to the worst.

It will also help them forecast changes in the tundra's vegetation. The softening of the soil and the consequent release of nutrients is likely to encourage the growth of shrubs on land that is now dominated by grass, moss and lichens. The researchers will monitor the growth of this vegetation around newly formed thermokarst features and use experimental field plots to test how conditions mimicking such features affect which species will thrive.

Last, the project will try to work out how thawing permafrost will affect the numerous streams, rivers and lakes of the Arctic. Together, these amount to the biggest acreage of water on "dry" land. As water moves through affected areas, it picks up both nutrients and sediment that would otherwise be held in the permafrost's icy grasp. These, paradoxically, have opposite effects on the growth of algae. The phosphates and nitrates stimulate it whereas the extra sediment suppresses it by trapping nutrients in the beds of such bodies of water.

Muddy waters

It is not only natural habitats and future generations that are threatened by the thawing of the permafrost. People in the here and now are affected, as well. Sediments from a huge thermokarstic area have, for example, dammed the Selawik River in north-western Alaska, interfering with fish and threatening the livelihood of nearby villages. Elsewhere in the state, a combination of melting sea ice and thawing permafrost has exacerbated the erosion of several coastal villages, which will have to be relocated at a considerable cost.

Whether anything short of reversing climate change can be done about all this is a moot question. But at least when the project reports, in five years' time, the size of the threat will be clearer. The news it brings may not be welcome. But it is surely better than living in ignorance about one of the world's most important habitats.

The US-Mexican border

A battle of wills and water

Jul 30th 2009
From The Economist print edition

A cult writer explores the secret world of migrant workers in America

AP

Imperial. By William T. Vollmann. *Viking; 1,306 pages; $55.* Buy from Amazon.com

TEN years in the making, William Vollmann's latest book, "Imperial", weighs in at a back-cricking four pounds (1.8kg). Were the author to devote the same attention to all the other 3,140 counties in America that he has to Imperial County in the extreme south-eastern corner of California, the result would stretch to more than 4m pages. Even for Mr Vollmann, that would be a tall order.

But perhaps nothing is impossible for a man who, despite being only 50, has already written around 20 books, including a seven-volume history of the idea of violence, which he promptly republished in a condensed version that runs to more than 700 pages, and who churns out novels as well as his peculiar blend of history-cum-reportage-cum-philosophy (he is still at work on "Seven Dreams", a cycle of seven novels about different aspects of the settlement of the Americas).

Is all this a symptom of logorrhoea or of genius? Possibly both. The reader's first impression on opening "Imperial" is that the publisher really ought to have assigned an editor to Mr Vollmann. Written in a mishmash of typefaces, its chapters alternately sprawling over 60 or 70 pages or just a couple of lines, "Imperial" leaps back and forth in time and geography like a maddened ping-pong ball. One has to wonder in what sense it really is a "book" at all, as opposed to the collection of jottings, musings, notes, documents and interviews that an author might assemble before settling down to the arduous business of selection and structuring involved in actually writing a book. It is, in short, a tall order to read.

But persevere. Skip huge tracts if you want to, dip in, dip out and don't worry about disrupting the narrative; there isn't one. Mr Vollmann has penetrated the soul of a place that is like few others on earth, but whose hardships and triumphs tell you something universal about the durability and ambition of the human spirit.

"Imperial" (and its companion volume of 200 pages of photographs that Mr Vollmann took as part of his research) is about two vast battles: the struggle for water, and the struggle for work. The struggle for water is the anterior theme. Until the Alamo canal, commissioned in 1901 and later replaced by the All-American Canal, brought water from the Colorado River to this arid inland part of southern California, precious little would grow there and only a few hundred exceptionally hardy settlers were able to eke out

a living. The county now numbers 160,000 souls.

Water, its supply and its rationing, runs through the book. WATER IS HERE, Mr Vollmann interjects in capital letters from time to time. But it is on this subject that the disjointed style is most problematic. The development of canals and irrigation and the consequent explosion of farming in the near-desert call for something much more linear than the author is constitutionally capable of providing.

Mr Vollmann's other big theme is the struggle for jobs and for a better life by Latino people on both sides of the border. It is here that his ability to talk, it seems, to anyone, stands him in best stead. Mr Vollmann has a well-known fascination with the seamier side of life, and "Imperial" gives him plenty to work with. Drug- runners and prostitutes, people-smugglers and border patrol-guards, sweatshop workers and private detectives fill his pages as he boldly goes where none of those who write the laws in faraway Washington, DC, has dared to tread. The best parts of this rambling opus are the ones where Mr Vollmann gives full vent to his conversations with other people.

Although "Imperial" is centred on the county of that name, it is not limited to it. Given that one of the author's themes is the arbitrariness of lines on a map, that is appropriate. So Mr Vollmann extends Imperial northward to the Salton Sea, a stinking lake sustained only by polluted run-off from the irrigation channels of Imperial County, and westward as far as Los Angeles. Most important, he ranges south too, into the Mexican borderland. He is constantly struck by the disparities that this particular artificial line creates. As an American he can cross the border as freely as a bird. For everyone he meets on the Mexican side the corresponding journey north is fraught with danger and obstacles. On the "Southside", as he calls it, Mr Vollmann walks "like a lord". On the "Northside" Mexicans slink like fugitives.

Profound though the author's sympathies are for the Mexicans he meets in the cities of Calexico and Mexicali, which straddle the Imperial County-Mexico border like lopsided twins, Mr Vollmann is an impressively honest observer. One of the best longer sections in the book is his investigation of the *maquiladoras*, factories set up on the Mexican side of the border to take advantage of low wages and easy access to American markets.

Reflexively accused of abusing the environment and workers, the *maquiladoras* are, nonetheless, also a source of jobs for people who would otherwise have no option but to work in the fields for less money and in the scorching heat. Mr Vollmann interviews dozens of *maquiladora* workers, tries with a comical lack of success to obtain damning photographs from inside the factories and is fair-minded enough to conclude that the charge of exploitation cannot really be sustained.

Some of the places "Imperial" takes the reader to are downright strange. There are the grim flophouses that Mr Vollmann enthusiastically frequents, doing his bit for Mexicali's hookers. But oddest of all are the Chinese tunnels in the Mexican city that he doggedly seeks out. Chinese immigrants used to live down there to escape notice and the heat, and they equipped themselves with restaurants, gambling dens and drinking clubs. All are gone now, but Mr Vollmann still manages to persuade a few suspicious landlords into letting him probe their fetid remnants.

What comes across most strongly is Mr Vollmann's love for the spirit he finds on the Mexican side of the border, and the disappointment he feels with the more sterile life on the American side. El Centro, the county town of Imperial, may have the highest unemployment rate of any metropolitan area in America, yet "Southsiders" are still desperate to make the crossing. Of course, that may be because they find the picturesque poverty of Mexicali a little less engaging than Mr Vollmann does.

Asia's quest for wealth

Going for growth

Jul 30th 2009
From The Economist print edition

The Miracle: The Epic Story of Asia's Quest for Wealth. By Michael Schuman. *Harper Business; 464 pages; $29.99 and £16.99*. Buy from Amazon.com, Amazon.co.uk

EPA

Digging in their heels

SOMETHING remarkable has swept through Asia in recent years, enriching literally billions of people far beyond even what optimists would have imagined just a few decades ago. In "The Miracle", Michael Schuman, Asia business correspondent for *Time* magazine, attempts to discern who and what energised each country, and beyond the obvious differences, whether certain features are common to them all.

The book explores some rich veins, beginning with the compelling, yet often flawed, people who forced their nations forward. These were men of broad vision, who were usually obsessed with micro-managing details. The leading exemplar was probably Park Chung-hee, president of South Korea from 1961 until 1979. Park would fly off by helicopter before dawn to inspect the construction of a highway project he believed was critical in linking together his country, only to find the project manager, Chung Ju-yung, subsequently better known as the founder of Hyundai, already at work, having slept at the site in the back of a Jeep.

As Mr Schuman illustrates, the men who led Asia's growth typically came out of slums and jungles, carving out their careers from what initially were trivial opportunities in regional militias or factories and accounting houses. Just a few, Azim Premji of India's Wipro, Akio Morita of Sony, and perhaps (more quietly) Li Ka-shing of Hong Kong, had ties to wealth. These men saw business as a noble calling. All of them were fiercely nationalistic; they took huge risks and occasionally came to a brutal end, as was the case for Chung's longtime rival, Kim Woo-choong, who created and destroyed Daewoo.

Mr Schuman goes to some lengths to show that many of Asia's successes happened after different industries threw off the heavy hand of the state. This was true even in Japan, the birthplace of the miracle, whose economy was heavily influenced by bureaucrats. Sony survived by circumventing government obstacles to American technology and Honda's car division made a point of resisting a government-imposed consolidation. India and China began to prosper once they emerged from under the influence of regulators and planners.

Despite that, the heavy role of the state snakes its way through Mr Schuman's book, for better and worse, providing an essential aspect of the narrative. Its influence was felt directly, through support for heavy industries like steel, shipbuilding, and car manufacturing, and also indirectly, through the creation of targeted economic development zones that were exempt from taxes and regulation, and lavished with subsidies. Most controversial were protectionist policies that were almost universally applied.

It is beyond argument that Asia benefitted from globalisation and an emphasis on exports that were happily consumed by other countries. However, benefiting from free trade is not the same as practising it. Japan, Taiwan, South Korea, Indonesia, Malaysia and China all built complex filters to allow the import of critical ingredients for production, including technology, capital equipment (when necessary) and energy, while protecting favourite domestic industries from foreign competition.

In return for protective laws, local Asian manufacturers were supposed to be obliged by their governments (or by the regulated banks that executed government policy through the allocation of credit) to produce goods that could compete in open markets against any others. Managers or companies that were not up to this task were swiftly meant to be allowed to fall away. In practice, though, as Mr

Schuman shows time and time again, the state, or its regulated banks, often lacked the strength or wisdom to impose such discipline.

Mr Schuman also draws attention to the crucial role America played. Willingly and unwillingly, it provided critical technology, from the transistors at the core of Japan’s televisions and radios to the semiconductor designs produced in Taiwan’s forges. It accepted products from Japan, South Korea and Taiwan when none of the three showed any reciprocity (something still true in many areas of China’s economy today). Moreover, many of America’s most dynamic companies were prepared both to open manufacturing operations throughout the region and to place critical initial orders with Asian companies so as to to help them launch industries such as India’s data outsourcing centres.

Whether America will continue to play a similar role is unclear. Trade imbalances are less tolerated than they once were. Tensions over intellectual property theft are likely to discourage American manufacturers from revealing and licensing technological innovation. Within Asia, friction is growing over self-interested nationalist policies that pit one country’s manufacturing sector against another. These tensions are likely to grow over time. Surmounting them will require a miracle. But as Mr Schuman’s book makes clear, that is surely no reason to be discouraged.

Arundhati Roy

Necessary, but wrong

Jul 30th 2009
From The Economist print edition

Listening to Grasshoppers: Field Notes on Democracy. By Arundhati Roy. *Hamish Hamilton; 256 pages; £14.99. To be published in America as "Field Notes on Democracy" by Haymarket Books in October*. Buy from Amazon.co.uk

IT IS impossible not to admire Arundhati Roy. Despite her flawed reporting and analysis, her left-wing prejudices and one-sided portentous writing, the author who carried off the 1997 Man Booker prize for her novel, "The God of Small Things", is just the sort of brave and energetic critic that India needs.

Not for her the national image projected by India's smug elite, of a nascent superpower lifting off. Ms Roy's India is a truer one—a poor, rural country beset by grave problems, where, notwithstanding the holding of regular elections, wretched injustices are perpetrated by a corrupt and often brutal state.

As prime evidence of democracy's failure to protect Indians, in this collection of her recent journalism and other writings, Ms Roy cites a massacre of perhaps 2,000 Muslims in Gujarat in 2002, in which the state's Hindu-nationalist government was allegedly complicit. Almost no senior official or Hinduist agitator has been prosecuted over the atrocity. And Narendra Modi, Gujarat's chief minister then and now, is currently vying to take over the leadership of the main opposition Bharatiya Janata Party, and one day India. Many of the country's industrialists would approve of that; even Ratan Tata, the gentlemanly head of the vast Tata Group which prides itself on its ethical dealings, has praised Mr Modi's business-friendly policies. Nothing annoys Ms Roy more.

The Hindu nationalists' hateful tendencies are well-known. Perhaps less notorious is the weakness of India's non-political institutions, and Ms Roy skewers most of them. In three deft articles, she examines the dubious methods of the police in securing the conviction of Muhammad Afzal Guru, a Kashmiri, for masterminding a 2001 terrorist attack on the Indian parliament building—allegedly by planting evidence and torturing him into confessing. Given that India's police are often alleged to use torture, and have long enjoyed impunity in Kashmir, where Mr Guru was picked up, this would not be surprising. But neither India's complacent judiciary nor its often-craven journalists shows much interest in reinvestigating his case. Mr Guru remains on death row.

Whether or not he is guilty, Ms Roy does laudable work in defending Mr Guru when others—including at times India's legal fraternity, according to Ms Roy—would not. On other issues, however, she is not always a reliable witness. Her claim that in Kashmir last summer protesters were as likely to call for union with Pakistan as freedom from India is probably wrong; most seemed to want to be shot of both countries.

But that faulty observation was at least noted by Ms Roy in the field. More typically, she appears to gather her facts from newspapers (her articles strike the reader rather as "lounge notes"), before selectively arranging and then exaggerating them to suit her own ends. For example, about 25% of India's territory is alleged to be affected by a Maoist insurgency, but that does not make it, as Ms Roy writes, "out of government control". Beyond India, her grasp of her subject-matter gets looser. If Ms Roy believes, as she writes, that a good portion of Africa's "contemporary horrors" are caused by America's "new colonial interests", she would do well to pay a visit to the continent.

So entrenched is the anti-globalisation that informs her world view, she would be tough to dissuade. But what alternative strategies does she advocate for improving India? Hard to say. A rare suggestion for better governance—the formation of a shadow parliament "that keeps an underground drumbeat"—does not seem terribly serious. On economic policy, Ms Roy has even less to offer—other than to slam recent governments for aspiring to rapid economic growth. This is a "project" she considers to be "encrypted with genocidal potential". For a more measured analysis, Ms Roy should perhaps turn to the finance ministry's recently published Economic Survey. There she would read that, "High growth is critical to generate the revenues needed for meeting our social welfare objectives." Ms Roy should take note.

Low temperatures

Lovin' a cold climate

Jul 30th 2009
From The Economist print edition

Illustration by Daniel Pudles

Cold: Adventures in the World's Frozen Places. By Bill Streever. *Little, Brown; 292 pages; $24.99 and £18.99*. Buy from Amazon.com, Amazon.co.uk

COLD has long had negative connotations—cold-hearted, cold feet, cold comfort, the cold war. Humans struggle to isolate themselves from it, hiding in overheated houses, taking winter holidays in hot climates. Cold kills the old and vulnerable. Christopher Robin-style wheezles and sneezles flourish in cold weather. Swine flu is expected to tighten its grip this winter. "Cold! If the thermometer had been an inch longer we'd all have frozen to death," wrote Opie Read in "Mark Twain and I".

Drawing on his experience of living in Anchorage, Alaska, Bill Streever, a biologist, takes the reader on a celebratory tour of the science, history, geography and ecology of cold temperatures. Humans, he writes, "fail to see cold for what it is: the absence of heat, the slowing of molecular motion, a sensation, a perception, a driving force."

Cold has a huge impact. It shapes landscapes. It herds animals along migration routes or forces them to hibernate. It changes soil, preserves food, inspires polar explorers and gives hope to those in search of resurrection now that bodies can be preserved in liquid nitrogen. Cold has changed the path of history. It stopped Alexander the Great's march into India. It blocked the Moors' invasion of France. During the second world war a quarter of a million German soldiers succumbed to frostbite and hypothermia in Russia, a help to the allied cause.

Mr Streever's toe-numbing adventures span the calendar. In July he takes a dip in an Arctic swimming hole. In October he studies animal hibernation. In March he goes on a survival course and learns about the "umbles": as hypothermia sets in you mumble, fumble, grumble, stumble, then finally tumble. Without help you die.

Along the way he introduces people made famous by cold: William Thomson, (Lord Kelvin), who proposed the concept of absolute zero, the point at which there is no heat (-459.67°F, or -273.15°C); Robert Goddard, who pioneered the use of liquefied gases as rocket fuel; Clarence Birdseye, who, in the 1920s, developed techniques for flash freezing food.

Mr Streever writes with passion and fills his book with entertaining facts. Around one-fifth of the world's land area lies within the permafrost zone. The heart rate of active bears is around 100 beats a minute; for hibernating bears it can drop to eight beats a minute. Blood circulation to the skin and hands is greater in Inuit people than in Europeans, protecting them from frostbite. It is possible for a moose to starve to death with its stomach full. Four-fifths of the world's fresh water is frozen.

The book's final chapter, however, takes on a more regretful tone as the author turns his attention to climate change and what it means for cold places. "Even in a warming world, a world choked by carbon dioxide and methane, cold persists," he writes. Though for how much longer is anyone's guess.

Economist.com BOOKS & ARTS

Rwenzori Sculpture Foundation

African bronze

Jul 30th 2009 | RWENZORI MOUNTAINS, UGANDA
From The Economist print edition

The challenge of building central Africa's first arts foundry

Cullum and Nightingale

Looking for bronze in them hills

THE Rwenzori mountains straddling Uganda and Congo are dark green and shrouded in rain clouds and mists which part only rarely to reveal dazzling equatorial glaciers. There is plenty of clean water rushing down from the peaks and the loamy valley floors are thick with banana, coffee, cassava—and silver-backed gorillas. On one of the foothills on the Ugandan side, not far from the town of Kasese, an impressive architectural project is beginning to take shape.

A London firm, Cullum and Nightingale, has won a competition there to design and build central Africa's first foundry for casting bronze sculptures. Once finished, it will also include an art gallery, a café, housing for visiting artists and a medical clinic to serve the needs of the local Bakonjo people. Richard Nightingale, who was born in Kenya, says his firm is best known for its architecture on sensitive sites and its attention to eco-design, as well as the care it takes in trying to replace imported cement and corrugated iron with locally sourced building materials—mud bricks and roofing made out of fuel drums. The firm has experience in Africa, having built the well-received British high commission buildings in Nairobi and Kampala.

On a recent visit, workers were painstakingly cutting a platform the size of a football pitch out of a hill using handpicks and shovels. The foundry will sit there, with panoramic views over the Rift Valley. The shape of an upturned galleon (see the model, pictured above), it will have a metal roof made of used oildrums beaten flat, and a keel-like beam running the whole length of the building, from which sculptures can be moved about on rails. The intention is to make the building dissolve from a distance into the black and green hillside, "like an elephant dissolves in the bush", Mr Nightingale says. Besides the views it offers, the site was chosen for the opportunity to buy copper from a local mine, the promise of reliable power from a nearby hydroelectric project and the chance of attracting tourists.

The foundry has been commissioned by the Rwenzori Sculpture Foundation, a British charity which aims to improve the quality of sculpture in Uganda and elsewhere in Africa, particularly bronzes. The main force behind the project is Rungwe Kingdon, who runs the largest bronze foundry of its kind in Europe, together with his wife, Claude Koenig. Their Cotswolds foundry, called Pangolin (after the scaled African anteater with a bronzy patina) has worked closely with some of Britain's leading sculptors and conceptual artists including Phillip King, Jon Buck, Ann Christopher, Damien Hirst and the late Angus Fairhurst.

Mr Kingdon's fascination with bronze dates back to his childhood growing up in Uganda, the son of a noted English zoologist and artist, Jonathan Kingdon. As an eight-year-old boy, he was given permission to help pour a first casting in the art department of Makerere University in Kampala. "I remember it like a film," he says fondly. After making a success of Pangolin, Mr Kingdon and Ms Koenig decided to try to put something back into Uganda.

A number of British artists have supported the venture. Mr Hirst recently travelled with Mr Kingdon to Kampala and donated a sculpture that was sold for £313,250 ($514,300) to help fund the building costs.

Mr Buck is one of the foundry’s first resident artists. Mr Kingdon says the plan is to build something on the scale of Pangolin, “but belonging wholly to Africa.”

A first step has been to train Ugandans in bronze casting, mostly skipping silicon-rubber treatments in favour of more traditional beeswax models. Several students were chosen from the same art department at Makerere where Mr Kingdon was first inspired. Having served a three-year apprenticeship in England, they recently returned to Uganda to build the first rudimentary foundry on the Kasese site.

Uganda has no tradition of sculpture: nothing like Kenya’s popular Kamba carvings, still less the sophisticated wood and stone sculptures of Benin or elsewhere in West Africa, which brought bold lines into the work of Constantin Brancusi and other modernists. The Ugandan tradition, instead, is in music. The Buganda people have musical signatures for each of their 52 clans. The clans also have a visual representation in the form of animals, plants, and even dung. Mr Buck is working with the Ugandan apprentices to make sculptures of some of the clan symbols. The hope is to sell these small bronzes to oil-rich Bugandans in Kampala for a few hundred dollars. Other early commissions have included a crested crane, now in Buckingham Palace, and trophies for BBC television awards.

Whether the foundry, which is 450km by road from the capital, succeeds in attracting enough interest to make it commercially viable remains to be seen. The long-term aim, however, is to use it to train a group of world-class African sculptors. By introducing a casting process that few Africans have seen and fewer still can afford, the foundry’s backers hope to inspire and give employment to hundreds more local people.

Leszek Kolakowski

Jul 30th 2009
From The Economist print edition

Leszek Kolakowski, a Polish-born Oxford philosopher, died on July 17th, aged 81

Piotr Wojcik Agencja Gazeta

HIS life was learning—about history, about his times, about himself. Like some other erstwhile true believers, he became one of most cogent critics of his former faith. Having spent his youthful years as an ardent communist and atheist, Leszek Kolakowski, one of the great minds of the modern era, turned into Marxism's most perceptive opponent, and one with a profound respect for religion.

His intellectual life started in the misery of Nazi-occupied Poland—he had to study in secret, mostly alone—and finished in one of the nicest places imaginable: Oxford's All Souls College. In a university tailor-made for gifted misfits, Mr Kolakowski was happy: he was left alone to read, write, and, less often, talk. All Souls provided a glorious academic retreat: the only obligation is to dine there regularly. His distinctive hat, craggy features, idiosyncratic English and perspex walking stick established him as a landmark even in a city studded with oddities and treasures.

"Philosopher" was his usual label, but not a wholly accurate one: historian of ideas would be better. Mr Kolakowski showed little interest in the Oxford tradition of analytical philosophy; like his great Oxonian philosophical contemporary, Isaiah Berlin, he formulated no grand scheme of ideas. His forte was to explain the development, attractiveness and shortcomings of political ideas and systems, particularly the communism invented by Karl Marx and practised across the Soviet empire.

His magnum opus was the three-volume "Main Currents of Marxism: Its Rise, Growth and Dissolution", published in the 1970s. It calmly and expertly demolished the pillars of Marxist thought: the labour theory of value, the idea of class struggle, historical materialism and the like. He also pointed out, again without unnecessary polemics, the practical shortcomings of communist systems. Stalinism was not an aberration, he argued, but the inevitable consequence of pursuing a communist utopia. For that, powerful left-wing voices such as the historian E.P. Thompson berated him as a traitor to the noble socialist ideals that he once espoused.

Against the devil

Both his experience and beliefs made such criticism seem patronising. Mr Kolakowski had lived under two kinds of totalitarianism, Nazism and communism; his ideas had been censored even in the supposedly more liberal communist Poland of the late 1950s and 1960s. What finally drove him, and his Jewish wife Tamara, to emigrate was the communist-inspired anti-Semitic campaign of 1968. Few if any of his leftist critics had such experiences. In a spirited rejoinder to Thompson, Mr Kolakowski wrote: "The only medicine communism has invented—the centralised, beyond social control, state ownership of the national wealth and one-party rule—is worse than the illness it is supposed to cure; it is less efficient economically and it makes the bureaucratic character of social relations an absolute principle."

His opponents in that argument seem to have landed on the dustheap of history. But Mr Kolakowski's distaste for communism did not make him an evangelist for free-market liberalism: he was too inquisitive, sceptical and irreverent to support any particular doctrine strongly. He was particularly critical of those who relied solely on science for answers to the big questions about life. He criticised too the emptiness of secular materialism. Increasingly, he became convinced that religion, in some form or other, was a necessary part of human existence. He was no churchgoer, but asked what his next target would be after communism, he replied, only half-jokingly, "the devil".

For those involved in the struggle against communism, on both sides of the iron curtain, he became a guru, ranking along with Czeslaw Milosz, the émigré Polish poet whose book "The Captive Mind", published in 1953, unpicked the mind-mangling effects of communist thought.

In those early days, of course, Mr Kolakowski was still a loyal, if critical, party member. Some of his fans preferred to forget that. They also overlooked his youthful tirades against Poland's Catholic church. As a zealous party member when the remnants of wartime anti-communism were still strong, he used to carry a pistol for fear of assassination. Remembering his father's murder during the Nazi occupation, the young Kolakowski accepted communism as an alternative both to Nazi militarism and to the failures of Poland's pre-war system of semi-authoritarian capitalism. Indeed his country's post-war communist rulers saw the brainy, determined youngster as a prize prospect and rewarded him with a trip to Moscow in 1950 to experience the delights of Soviet rule.

That backfired. He wrote later of the "material and spiritual desolation" he saw there, though it took two decades for his faith in Poland's socialist system to erode entirely. In the late 1960s, he made his way to America but found the radical campus leftism "pathetic and disgusting"; no place to bring up his daughter, he felt. He visited America regularly, though, and it was in his Jefferson lecture, the highest honour the federal government gives for intellectual achievement, that he coined his best-known aphorism: "We learn history not in order to know how to behave or how to succeed, but to know who we are."

Overview

Jul 30th 2009
From The Economist print edition

There was some good news from **America's housing market**. Sales of new single-family homes increased by 11% in June to an annual rate of 384,000. However, this was still 21.3% lower than in June 2008. The prices of houses in the 20 largest cities rose by 0.5% in May, according to the S&P/Case-Shiller index, the first increase since July 2006. Prices were 17.1% lower than a year before.

An index of **American consumer confidence** fell to 46.6 in July from 49.3 in June, said the Conference Board, a research group.

New orders for **durable goods in America** declined by 2.5% in June to $158.6 billion, after rising in both April and May. The biggest declines were in orders for transport equipment. Orders for other durable goods increased by 1.1%.

Japan's industrial output went up by 2.4% in June. Although this was the fourth monthly rise in a row, output was 23.4% down on a year earlier.

Britain's GDP fell by 0.8% in the three months to June, having declined by 2.4% in the first quarter. The economy shrank by 5.6% in the year to the second quarter, the largest contraction since comparable records began in 1955.

The annual rate of consumer-price inflation in **South Africa** fell to 6.9% in June from 8% in May.

Hungary's central bank lowered its key interest rate by a percentage point to 8.5%.

Output, prices and jobs

Jul 30th 2009
From The Economist print edition

Output, prices and jobs

% change on year ago

	Gross domestic product				Industrial production	Consumer prices			Unemployment
	latest	qtr*	2009†	2010†	latest	latest	year ago	2009†	rate‡, %
United States	−2.5 Q1	−5.5	−2.7	+2.0	−13.6 Jun	−1.4 Jun	+5.0	−0.4	9.5 Jun
Japan	−8.8 Q1	−14.2	−6.1	+1.0	−23.4 Jun	−1.1 May	+1.3	−1.1	5.2 May
China	+7.9 Q2	na	+7.2	+7.6	+10.7 Jun	−1.7 Jun	+7.1	−0.5	9.0 2008
Britain	−5.6 Q2	−3.2	−3.7	+1.1	−11.9 May	+1.8 Jun§	+3.8	+1.7	7.6 May††
Canada	−2.1 Q1	−5.4	−2.2	+1.9	−9.9 Apr	−0.3 Jun	+3.1	+0.6	8.6 Jun
Euro area	−4.9 Q1	−9.8	−4.4	+0.6	−17.0 May	−0.1 Jun	+4.0	+0.4	9.5 May
Austria	−3.5 Q1	−10.6	−3.2	+0.2	−10.9 Apr	nil Jun	+3.9	+0.5	4.3 May
Belgium	−3.0 Q1	−6.2	−3.5	+0.4	−19.9 Apr	−1.1 Jun	+5.8	+0.4	11.0 May‡‡
France	−3.2 Q1	−4.8	−2.9	+0.7	−13.4 May	−0.5 Jun	+3.6	+0.2	9.3 May
Germany	−6.9 Q1	−14.4	−6.0	+0.6	−18.1 May	−0.6 Jul	+3.3	+0.2	8.3 nil
Greece	+0.3 Q1	−4.6	−3.0	−0.9	−7.2 May	+0.5 Jun	+4.9	+0.4	9.4 Apr
Italy	−6.0 Q1	−10.1	−5.0	+0.4	−19.8 May	+0.6 Jun	+3.8	+0.9	7.3 Q1
Netherlands	−4.5 Q1	−10.7	−4.5	+0.7	−12.7 May	+1.4 Jun	+2.6	+1.3	4.7 Jun††
Spain	−3.0 Q1	−7.4	−3.8	−0.6	−22.3 May	−1.4 Jul	+5.3	−0.3	18.7 May
Czech Republic	−3.4 Q1	−12.9	−3.0	+1.2	−22.0 May	+1.2 Jun	+6.7	+1.7	8.0 Jun
Denmark	−4.1 Q1	−4.2	−3.7	+0.6	−16.5 May†††	+1.2 Jun	+3.8	+1.2	3.8 Jun
Hungary	−6.7 Q1	−9.6	−6.3	−1.0	−22.1 May	+3.7 Jun	+6.7	+4.3	9.8 May††
Norway	+1.5 Q1	−1.8	−2.0	+0.5	−7.8 May	+3.4 Jun	+3.4	+2.1	3.1 Apr***
Poland	+0.8 Q1	na	−0.8	+1.5	−4.3 Jun	+3.5 Jun	+4.6	+2.5	10.7 Jun‡‡
Russia	−9.5 Q1	na	−7.0	+2.5	−12.1 Jun	+11.9 Jun	+15.2	+12.1	8.3 Jun‡‡
Sweden	−6.5 Q1	−3.6	−5.1	+1.1	−21.9 May	−0.6 Jun	+4.3	−0.3	9.8 Jun‡‡
Switzerland	−2.4 Q1	−16.0	−2.2	+0.4	−9.4 Q1	−1.0 Jun	+2.9	−0.5	3.8 Jun
Turkey	−13.8 Q1	na	−5.6	+2.2	−17.4 May	+5.7 Jun	+10.6	+6.2	14.9 Apr‡‡
Australia	+0.4 Q1	+1.5	−0.2	+1.7	−3.6 Q1	+1.5 Q2	+4.5	+1.8	5.8 Jun
Hong Kong	−7.8 Q1	−16.1	−6.0	+1.1	−10.2 Q1	−0.9 Jun	+6.1	+1.0	5.4 Jun††
India	+5.8 Q1	na	+5.5	+6.4	+2.7 May	+8.6 May	+7.8	+5.2	6.8 2008
Indonesia	+4.4 Q1	na	+2.4	+3.1	+1.8 May	+3.7 Jun	+11.0	+4.2	8.1 Feb
Malaysia	−6.2 Q1	na	−5.2	+3.4	−11.1 May	−1.4 Jun	+7.7	−0.3	4.0 Q1
Pakistan	+5.8 2008**	na	+3.7	+2.8	−14.1 Apr	+13.1 Jun	+21.5	+12.0	5.2 2008
Singapore	−3.7 Q2	+20.4	−8.6	+1.3	−9.3 Jun	−0.5 Jun	+7.5	−0.2	3.3 Q1
South Korea	−2.5 Q2	+9.7	−4.4	+0.5	−9.0 May	+2.0 Jun	+5.5	+1.6	4.0 Jun
Taiwan	−10.2 Q1	na	−6.5	+0.6	−11.4 Jun	−2.0 Jun	+5.0	−1.3	5.9 Jun
Thailand	−7.1 Q1	−7.3	−4.5	+1.9	−10.0 May	−4.0 Jun	+8.8	−1.0	2.4 May
Argentina	+2.0 Q1	+0.2	−3.5	+0.5	−12.2 May	+5.3 Jun	+9.3	+7.0	8.4 Q1‡‡
Brazil	−1.8 Q1	−3.3	−1.2	+2.7	−11.3 May	+4.8 Jun	+6.1	+4.9	8.1 Jun‡‡
Chile	−2.1 Q1	−2.4	−1.0	+2.2	−14.2 Jun	+1.9 Jun	+9.5	+2.1	10.2 May††‡‡
Colombia	−0.6 Q1	+0.9	−1.2	+2.5	−6.5 May	+3.8 Jun	+7.2	+5.0	11.7 May‡‡
Mexico	−8.2 Q1	−21.5	−7.1	+2.8	−11.6 May	+5.7 Jun	+5.3	+5.5	5.2 Jun‡‡
Venezuela	+0.3 Q1	na	−4.1	−2.7	−11.3 Feb	+27.4 Jun	+32.2	+30.2	8.1 Q1‡‡
Egypt	+4.3 Q1	na	+4.0	+3.8	+5.7 Q4	+10.0 Jun	+20.2	+9.7	9.4 Q1‡‡
Israel	+0.6 Q1	−3.6	−1.0	+1.6	−9.8 May	+3.6 Jun	+4.8	+2.7	7.6 Q1
Saudi Arabia	+4.2 2008	na	−1.0	+3.1	na	+5.5 May	+10.4	+4.3	na
South Africa	−1.3 Q1	−6.4	−2.2	+3.1	−17.1 May	+6.9 Jun	+12.2	+6.6	23.5 Mar‡‡
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*									
Estonia	−15.1 Q1	na	−13.0	−3.0	−30.0 May	−0.9 Jun	+11.4	+0.2	13.9 Apr
Finland	−7.6 Q1	−10.3	−5.6	−0.1	−23.2 May	−0.1 Jun	+4.4	+0.3	8.8 Jun
Iceland	−3.9 Q1	−13.6	−6.5	−0.7	+10.1 2008	+11.3 Jul	+13.6	+12.5	8.7 May‡‡
Ireland	−8.5 Q1	−5.7	−7.5	−2.8	−4.2 May	−5.4 Jun	+5.0	−3.5	11.9 Jun
Latvia	−18.0 Q1	na	−17.0	−4.0	−19.3 May	+3.4 Jun	+17.7	+3.0	16.3 May
Lithuania	−22.4 Q2	−40.8	−15.0	−4.5	−19.3 May	+4.2 Jun	+12.5	+5.5	9.3 Jun‡‡
Luxembourg	−5.2 Q4	−16.8	−5.0	−0.9	−25.9 Apr	−0.3 Jun	+4.3	+0.5	5.4 May‡‡
New Zealand	−2.2 Q1	−2.7	−2.6	+0.7	−7.2 Q4	+1.9 Q2	+4.0	+1.4	5.0 Q1
Peru	+0.5 May	na	+1.3	+2.6	−8.6 May	+3.1 Jun	+5.7	+3.8	8.3 Jun‡‡
Philippines	+0.4 Q1	−8.9	−1.8	+3.0	−13.0 May	+1.5 Jun	+11.4	+2.9	7.5 Q2‡‡
Portugal	−3.7 Q1	−6.2	−4.1	−0.4	−7.9 May	−1.6 Jun	+3.4	−0.7	8.9 Q1‡‡
Slovakia	−5.6 Q1	na	−5.0	+0.7	−23.9 May	+2.4 Jun	+4.6	+1.6	11.8 Jun‡‡
Slovenia	−8.5 Q1	na	−5.0	+0.5	−19.8 May	+0.3 Jun	+7.0	+1.1	8.9 May‡‡
Ukraine	−8.0 Q4	na	−12.0	+1.0	−27.5 Jun	+15.0 Jun	+29.3	+16.0	2.4 Jun
Vietnam	+4.5 Q2	na	+4.2	+4.8	+8.2 Jun	+3.3 Jul	+27.0	+5.6	4.6 2007

*% change on previous quarter, annual rate. †The Economist poll or Economist Intelligence Unit estimate/forecast. ‡National definitions. §RPI inflation rate -1.6 in June. **Year ending June. ††Latest three months. ‡‡Not seasonally adjusted. ***Centred 3-month average

Sources: National statistics offices and central banks; Thomson Datastream; Reuters; Centre for Monitoring Indian Economy; OECD; ECB

The Economist commodity-price index

Jul 30th 2009
From The Economist print edition

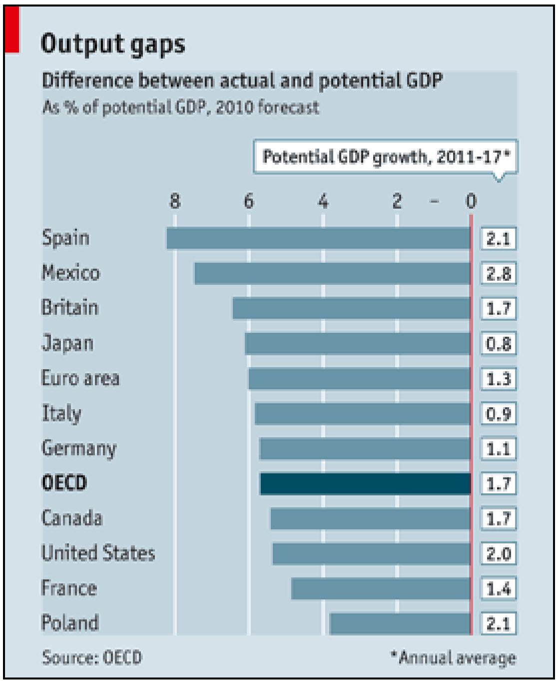
***The Economist* commodity-price index**
2000=100

	Jul 21st	Jul 28th*	% change on one month	% change on one year
Dollar index				
All items	183.1	186.7	+2.0	-25.6
Food	196.8	197.7	-2.8	-21.8
Industrials				
All	165.5	172.6	+10.2	-30.5
Nfa†	136.8	137.4	+12.6	-31.4
Metals	181.1	191.9	+9.3	-30.2
Sterling index				
All items	168.7	171.9	+2.0	-10.5
Euro index				
All items	119.0	121.8	+1.0	-18.2
Gold				
$ per oz	949.00	953.65	+1.7	+3.9
West Texas Intermediate				
$ per barrel	64.78	67.31	-3.8	-44.9

*Provisional †Non-food agriculturals.

Output gaps

Jul 30th 2009
From The Economist print edition



The output gap is the difference between actual economic output and the most an economy can sustainably produce, given the amounts of capital, technology and labour available. The OECD forecasts that in 2010 it will average 5.7% of potential GDP for its mostly rich member countries. At 8.2%, Spain's output gap will be one of the largest. The crisis is also affecting potential output, mainly through the collapse in investment. The OECD reckons that Mexico's potential GDP will grow by 2.8% per year between 2011 and 2017. Growth in potential output will average 2.1% in Spain and Poland, and 2% in America. But Japan's potential output will grow by a mere 0.8% a year during this period, and Italy's by only 0.9%.

Trade, exchange rates, budget balances and interest rates

Jul 30th 2009
From The Economist print edition

Trade, exchange rates, budget balances and interest rates

	Trade balance* latest 12 months, $bn	Current-account balance latest 12 months, $bn	Current-account balance % of GDP 2009†	Currency units, per $ Jul 29th	Currency units, per $ year ago	Budget balance % of GDP 2009†	Interest rates, % 3-month latest	Interest rates, % 10-year gov't bonds, latest
United States	−674.4 May	−628.3 Q1	−3.0	–	–	−13.7	0.26	3.66
Japan	+5.1 May	+107.7 May	+1.9	95.0	108	−6.8	0.41	1.37
China	+286.7 Jun	+426.1 Q4	+7.2	6.83	6.83	−4.3	1.65	3.75
Britain	−145.4 May	−52.5 Q1	−1.7	0.61	0.51	−14.4	0.90	3.97
Canada	+21.1 May	−3.9 Q1	−1.8	1.09	1.02	−2.3	0.24	3.53
Euro area	−46.2 May	−158.1 May	−1.0	0.71	0.64	−5.9	0.90	3.43
Austria	−5.4 Apr	+10.7 Q1	+2.0	0.71	0.64	−5.2	0.90	3.90
Belgium	+6.0 Apr	−12.0 Mar	−2.4	0.71	0.64	−5.8	0.92	3.88
France	−73.9 May	−59.4 May	−2.2	0.71	0.64	−8.2	0.90	3.62
Germany	+196.3 May	+171.0 May	+3.9	0.71	0.64	−4.7	0.90	3.42
Greece	−56.2 Apr	−42.9 May	−8.8	0.71	0.64	−6.5	0.90	4.67
Italy	−11.9 May	−63.1 May	−2.8	0.71	0.64	−5.2	0.90	4.26
Netherlands	+44.1 May	+50.0 Q1	+6.1	0.71	0.64	−4.1	0.90	3.75
Spain	−101.4 May	−124.7 Apr	−7.2	0.71	0.64	−9.8	0.90	3.93
Czech Republic	+4.1 May	−6.3 May	−1.9	18.2	15.4	−4.7	2.10	5.51
Denmark	+6.5 May	+8.5 May	+1.5	5.29	4.80	−2.5	1.98	3.71
Hungary	+1.3 May	−11.3 Q1	−2.9	192	148	−3.9	8.50	8.80
Norway	+61.0 Jun	+79.6 Q1	+14.4	6.24	5.15	7.4	1.84	4.05
Poland	−16.2 May	−15.7 May	−5.0	2.97	2.06	−4.0	4.16	6.17
Russia	+131.5 May	+55.3 Q2	+1.9	31.7	23.5	−8.0	11.00	10.93
Sweden	+13.6 Jun	+31.4 Q1	+7.0	7.48	6.07	−4.7	0.07	3.38
Switzerland	+16.9 Jun	+56.6 Q1	+7.6	1.08	1.05	−3.1	0.36	2.01
Turkey	−51.0 May	−23.8 May	−0.6	1.49	1.18	−5.9	9.03	6.25‡
Australia	+6.6 May	−29.8 Q1	−4.1	1.22	1.06	−4.0	3.16	5.60
Hong Kong	−20.7 Jun	+29.3 Q1	+10.4	7.75	7.80	−4.0	0.23	2.20
India	−96.4 May	−29.8 Q1	−1.9	48.4	42.4	−7.8	3.27	7.54
Indonesia	+10.4 May	−0.8 Q1	+0.9	9,955	9,123	−3.0	7.24	7.00‡
Malaysia	+39.7 May	+40.5 Q1	+13.5	3.53	3.26	−8.0	2.13	2.28‡
Pakistan	−16.8 Jun	−12.2 Q1	−2.1	83.1	71.6	−4.3	11.83	13.53‡
Singapore	+17.4 Jun	+23.1 Q1	+15.4	1.45	1.37	−4.1	0.50	2.22
South Korea	+15.2 Jun	+20.7 Jun	+2.7	1,240	1,014	−5.4	2.41	5.17
Taiwan	+12.8 Jun	+29.2 Q1	+10.4	32.8	30.5	−5.2	0.85	1.39
Thailand	+10.2 Jun	+8.3 May	+5.3	34.0	33.5	−5.6	1.40	3.09
Argentina	+17.1 Jun	+6.8 Q1	+2.0	3.82	3.03	−1.2	14.50	na
Brazil	+27.5 Jun	−18.4 Jun	−1.3	1.89	1.56	−2.0	8.65	6.16‡
Chile	+4.5 Jun	−4.3 Q1	−0.9	543	504	−4.1	0.84	2.80‡
Colombia	nil Apr	−6.5 Q1	−3.7	2,067	1,790	−3.4	5.24	5.71‡
Mexico	−16.0 Jun	−14.2 Q1	−2.7	13.3	10.0	−5.4	4.51	7.86
Venezuela	+32.5 Q1	+26.2 Q1	+1.1	6.89	3.25§	−4.7	14.50	6.55‡
Egypt	−26.1 Q1	−2.9 Q1	−1.5	5.55	5.31	−7.1	10.18	2.92‡
Israel	−9.2 Jun	+4.1 Q1	+1.7	3.81	3.49	−6.2	0.60	4.11
Saudi Arabia	+197.4 2008	+124.0 2008	−2.1	3.75	3.75	−5.1	0.64	na
South Africa	−5.8 May	−18.7 Q1	−5.8	7.89	7.39	−4.5	7.75	9.00
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*								
Estonia	−2.5 May	−0.8 May	+0.7	11.1	10.1	−3.7	6.08	na
Finland	+6.3 May	+4.2 May	+0.8	0.71	0.64	−2.6	0.88	3.74
Iceland	+0.3 Jun	−6.1 Q1	+2.2	129	80.3	−13.0	8.02	na
Ireland	+47.7 May	−11.3 Q1	−2.2	0.71	0.64	−12.6	0.90	4.94
Latvia	−4.3 May	−1.7 May	−2.0	0.50	0.45	−11.0	13.60	na
Lithuania	−4.3 May	−2.2 May	−2.0	2.46	2.22	−6.1	8.38	na
Luxembourg	−7.3 Apr	+2.2 Q1	na	0.71	0.64	−3.8	0.90	na
New Zealand	−2.3 Jun	−11.8 Q1	−7.1	1.52	1.36	−6.7	3.75	5.75
Peru	+1.9 May	−3.8 Q1	−2.4	2.99	2.81	−2.3	2.00	na
Philippines	−6.9 May	+5.1 Mar	+3.8	48.1	44.1	−3.4	4.25	na
Portugal	−30.7 Apr	−24.5 May	−8.7	0.71	0.64	−7.0	0.90	4.02
Slovakia	−0.3 May	−5.4 May	−7.0	21.4	19.5	−5.5	1.35	4.38
Slovenia	−3.4 May	−2.1 Apr	−1.7	0.71	0.64	−5.1	0.90	na
Ukraine	−13.4 Q1	−6.5 Q2	−0.3	7.81	4.68	−4.3	11.82	na
Vietnam	−5.4 Jul	−7.0 2007	−6.9	17,816	16,765	−9.0	8.26	6.87

*Merchandise trade only. †The Economist poll or Economist Intelligence Unit forecast. ‡Dollar-denominated bonds. §Unofficial exchange rate.

Markets

Jul 30th 2009
From The Economist print edition

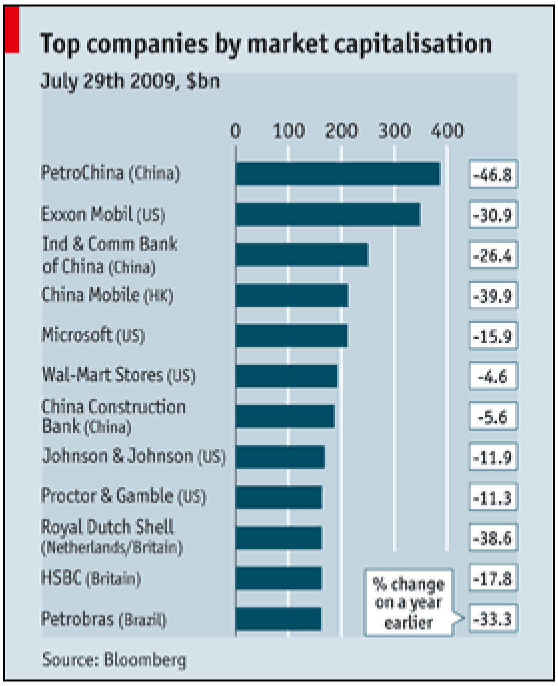
Markets

	Index Jul 29th	% change on one week	Dec 31st 2008 in local currency	Dec 31st 2008 in $ terms
United States (DJIA)	9,070.7	+2.1	+3.4	+3.4
United States (S&P 500)	975.2	+2.2	+8.0	+8.0
United States (NAScomp)	1,959.4	+1.7	+24.2	+24.2
Japan (Nikkei 225)	10,113.2	+4.0	+14.2	+8.9
Japan (Topix)	930.4	+2.6	+8.3	+3.3
China (SSEA)	3,428.9	-0.9	+79.4	+79.1
China (SSEB, $ terms)	210.1	-0.1	+89.6	+89.4
Britain (FTSE 100)	4,547.5	+1.2	+2.6	+17.1
Canada (S&P TSX)	10,455.3	+0.2	+16.3	+32.0
Euro area (FTSE Euro 100)	801.8	+2.8	+7.4	+8.7
Euro area (DJ STOXX 50)	2,600.3	+2.8	+6.2	+7.5
Austria (ATX)	2,207.1	+3.6	+26.1	+27.5
Belgium (Bel 20)	2,120.4	-0.2	+11.1	+12.4
France (CAC 40)	3,365.6	+1.8	+4.6	+5.8
Germany (DAX)*	5,270.3	+2.9	+9.6	+10.8
Greece (Athex Comp)	2,276.2	+0.2	+27.4	+28.9
Italy (S&P/MIB)	20,282.0	+1.8	+4.2	+5.4
Netherlands (AEX)	277.3	+2.3	+12.8	+14.1
Spain (Madrid SE)	1,109.5	+5.2	+13.7	+15.0
Czech Republic (PX)	994.3	+4.1	+15.9	+23.0
Denmark (OMXCB)	283.7	+0.7	+25.4	+26.9
Hungary (BUX)	16,487.9	+2.5	+34.7	+34.4
Norway (OSEAX)	337.5	-1.6	+24.9	+40.0
Poland (WIG)	33,822.1	+3.0	+24.2	+23.8
Russia (RTS, $ terms)	973.8	+1.1	+59.8	+54.1
Sweden (OMXS30)†	858.1	+0.6	+29.6	+37.0
Switzerland (SMI)	5,787.2	+2.7	+4.6	+2.6
Turkey (ISE)	40,376.6	+5.7	+50.3	+55.5
Australia (All Ord.)	4,148.9	+2.0	+13.4	+31.4
Hong Kong (Hang Seng)	20,135.5	+4.6	+40.0	+40.0
India (BSE)	15,173.5	+2.2	+57.3	+58.3
Indonesia (JSX)	2,225.8	+4.7	+64.2	+79.8
Malaysia (KLSE)	1,164.5	+1.4	+32.8	+30.1
Pakistan (KSE)	7,537.0	-3.4	+28.5	+22.4
Singapore (STI)	2,604.1	+6.3	+47.8	+47.3
South Korea (KOSPI)	1,524.3	+2.0	+35.6	+37.7
Taiwan (TWI)	7,083.6	+1.4	+54.3	+54.2
Thailand (SET)	614.9	+2.8	+36.7	+39.7
Argentina (MERV)	1,655.7	+0.8	+53.4	+38.8
Brazil (BVSP)	53,734.0	+1.2	+43.1	+76.2
Chile (IGPA)	15,301.5	nil	+35.1	+58.7
Colombia (IGBC)	10,044.4	+0.3	+32.9	+44.5
Mexico (IPC)	26,516.5	+0.9	+18.5	+23.8
Venezuela (IBC)	46,211.3	+1.0	+31.7	+41.8
Egypt (Case 30)	6,106.0	+2.7	+32.8	+31.9
Israel (TA-100)	884.7	+5.2	+56.8	+55.5
Saudi Arabia (Tadawul)	5,670.5	+0.7	+18.1	+18.2
South Africa (JSE AS)	23,589.3	-0.1	+9.7	+28.5
Europe (FTSEurofirst 300)	910.7	+2.3	+9.5	+10.7
World, dev'd (MSCI)	1,023.4	+1.8	+11.2	+11.2
Emerging markets (MSCI)	822.4	+2.0	+45.0	+45.0
World, all (MSCI)	260.5	+1.8	+14.4	+14.4
World bonds (Citigroup)	804.8	-0.8	-0.6	-0.6
EMBI+ (JPMorgan)	450.8	+0.5	+15.1	+15.1
Hedge funds (HFRX)§	1,087.5	+0.4	+6.6	+6.6
Volatility, US (VIX)	25.6	23.5	40.0	(levels)
CDSs, Eur (iTRAXX)‡	110.3	-7.0	-45.4	-44.8
CDSs, N Am (CDX)‡	166.2	-7.7	-28.8	-28.8
Carbon trading (EU ETS) €	13.6	-5.2	-15.4	-14.4

*Total return index. †New series. ‡Credit-default swap spreads, basis points. Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; JPMorgan Chase; Bank Leumi le-Israel; CBOE; CMIE; Danske Bank; EEX; HKMA; Markit; Standard Bank Group; UBS; Westpac. §Jul 28th

Top companies by market capitalisation

Jul 30th 2009
From The Economist print edition



Although PetroChina's market capitalisation has fallen by 47% in the past year, it remains the world's most valuable company. Chinese firms now occupy three of the top four slots. (The state's large non-traded holdings are valued at market prices.) Seven of the 12 most valuable companies are either banks or oil producers. Wal-Mart, Johnson & Johnson and Procter & Gamble have all climbed the table in the past year; their industries tend to weather recessions better than others. Market capitalisation does not necessarily tally with other measures of size. Microsoft is worth more than Royal Dutch Shell, which has nearly eight times the revenue of the software company and 10,000 more employees.